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Supreme Court of the United States.

OCTOBER TERM, 1940.

No. 684.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

RICHARD J. REYNOLDS.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.

BRIEF FOR RESPONDENT ON THE WRIT AND IN OPPOSITION TO PETITIONER'S MOTION TO REVERSE.

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April, 1941.

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OPINIONS BELOW.

The opinion of the Board (R. 28) is reported in 41 B. T. A. 59. The opinion of the Circuit Court of Appeals (R. 41) is reported in 114 F. (2d) 804.

QUESTIONS PRESENTED.

On April 4, 1934, respondent became entitled to certain securities and on that day he obtained them as his own. Prior to that date they did not belong to him and he had no interest in the said securities. On the day on which he became entitled to the securities he received them from the Trustee of a testamentary trust established by the will of his father who died in 1918.

Some of the securities acquired by respondent on April 4, 1934, were securities which had been owned by his father at the time of his death. Others were purchased by the Trustee between 1918 and 1934.

The question is whether respondent "acquired" the securities when he became entitled to them, when they became his, and when he received them on April 4, 1934, or whether he "acquired" them partly when his father died in 1918, and partly as the Trustee purchased them from time to time between 1918 and 1934.

STATUTE AND REGULATIONS INVOLVED.

The statute and regulations involved are set out in the Appendix, *infra*, pp. 1–2.

STATEMENT.

This case was submitted on a stipulation which is found at R. 24. The stipulation included two exhibits (Exhibits A and B). The pertinent provisions of the will of R. J. Reynolds (including Items "Fourth" and "Eighth") appear at R. 16–21.

R. J. Reynolds died testate on July 19, 1918, a resident of North Carolina. In his will he created a trust for the benefit of his four children. Respondent was the oldest of the four children and was 12 years of age when his father died. The trust provided that the trustee should apply so much of the trust *income* as was necessary for the support, maintenance and education of each child until such child became 21 years of age; to pay each child an annual *income* of not less than $5,000 from the date such child became 21, and until he attained the age of 28; to accumulate the balance of the trust income for the respective use of each child "until he or she shall respectively attain the age of twenty-eight (28) years, *when each of them shall become entitled to* and shall respectively receive from said Trustee his or her share of the corpus."

The will further provided that: "Should any of my children

die before he or she shall arrive at the age of twenty-eight (28) years, *then* the share of my estate *which would have been* payable to him or her, *had he or she arrived at that age*, shall be continued to be held by my said Trustee" for the benefit of a devisee of such child until the date when such child would have reached 28 (if he had lived that long), at which time the trust should terminate and be payable to such devisee.

The will also provided that in the event such child did not live to the age of 28, and died intestate, leaving issue, the Trustee should continue the trust for the benefit of such *issue* until the date such *child* would have reached 28 (if he had lived that long), at which time "the trust shall cease and the estate shall become vested" in such issue as may be living at that date. In the event all four children died intestate, and without issue, before reaching 28, the estate was to vest in the wife, brothers and sisters *of the testator*.

Respondent attained the age of 28 on April 4, 1934. On that date the Trustee transferred to him certain stocks and other securities representing his share of the trust corpus. The stock so delivered was stock which the Trustee had received from the estate of the testator. The other securities were securities which the Trustee had purchased at various times between 1918 and 1934.

Later in 1934 respondent sold some of the said stock and securities. In computing his gains and losses, respondent used as his basis the value of the property on April 4, 1934. The Commissioner recomputed the gains and losses by using, as the basis, the value of the stock at the date of the death of R. J. Reynolds in 1918, and the cost of the other securities to the Trustee when it purchased them.

The Courts of North Carolina (including the Supreme Court) have interpreted the instant will and trust and have determined the nature and extent of respondent's rights thereunder. The North Carolina Courts decided and held that unless and until he arrived at the age of 28 the only right he had under his father's will was to receive certain amounts of *income* if, as and when such *income* became payable to him; that no part of

the trust property would have vested in respondent unless and until he had arrived at the age of 28; that the will of respondent's father did not bequeath or devise to respondent any vested interest or share in the trust estate or any part thereof; that prior to the age of 28 the respondent did not own an interest in the trust property with possession thereof postponed until he should reach the age of 28; that during that period respondent did not own an interest which was subject to divestment by death before the age of 28; and that during that period respondent had only the possibility of receiving property in interest and in possession if, as, and when he should attain the age of 28.

Respondent contended below, and still contends, that prior to April 4, 1934, he did not become entitled to the property and hence did not own it; that he could not "acquire" the property before he became entitled to it and had the ownership of an interest in it; and that he could not have acquired it before April 4, 1934. The Commissioner contended that regardless of the foregoing the respondent nevertheless acquired the property prior to April 4, 1934.

The Board sustained the Commissioner upon the authority of *Augustus*, 40 B. T. A. 1201, and *Archbold*, 40 B. T. A. 1238. In the *Augustus* case five members dissented with an opinion. In the *Archbold* case six members dissented with an opinion. We respectfully invite this Court's attention to those dissents.

The Circuit Court of Appeals reversed the Board.

* * * * *

At page 5 of his brief, in his specifications of error, petitioner states that the Court below held that the basic value of the securities was their value on the date of "distribution." It is respectfully submitted that the Court below held no such thing. The Court below held that the basic value was the value on the date when respondent "acquired" the securities. The decision below was in no wise concerned with the time of "distribution," nor did the decision below in any way turn upon the issue of distribution. The Supreme Court has recently decided certain cases arising under a different statute in which the date of

"distribution" was the basic date. Respondent herein respectfully prays the Court not to be confused by the possibly inadvertent statement contained twice in petitioner's specification of errors.

SUMMARY OF ARGUMENT.

1. The 1934 Act (reenacting the provisions of the Acts of 1921, 1924 and 1926) provides that the property *which is acquired* shall take as its basis the fair market value *"at the time of such acquisition."*

2. Both prior and subsequent to the enactment of the 1934 Act many decisions of the Supreme Court, Circuit Courts, the Board, and the Department, had construed "time of acquisition" to mean the date on which the taxpayer obtained the property as his own and became the owner of a substantial property right in the trust corpus.

3. The Courts of North Carolina have construed the instant will and held that it did not bequeath or devise to respondent any share of the trust corpus; that respondent's only right under the will was to receive certain *income* if, as, and when payable to him; that prior to reaching age 28, respondent did not have an interest which was merely postponed as to time of possession; that prior to reaching age 28, respondent did not have an interest which was subject to defeasance or divestment by death before reaching 28 years; and that prior to age 28, respondent had only the expectancy or possibility of receiving an interest in, and possession of, certain trust property. 208 N. C. 578.

4. The rule of property laid down by the Supreme Court of North Carolina is binding upon the courts and is dispositive of the issue here.

5. Neither Congress by legislation, nor the Treasury Department by regulation can make that to be a fact which is not a fact, nor can the Treasury Department by regulation construe an Act contrary to its plain intendment.

6. The reenactment of sec. 113 (a) (5) of the 1934 Act in the

same language as that contained in the corresponding sections of the Revenue Acts of 1926, 1924 and 1921, constituted an approval of the interpretation put upon that language by the Courts and the Department, and such construction has the force and effect of law.

7. The recent decisions of this Court in *Maguire*, No. 346, *Gambrill*, No. 472, *Campbell*, Nos. 473–475, are not controlling here. The point decided in those cases (under a different statute) was that "distribution to the taxpayer" meant either distribution to him personally or to someone who represented him in such capacity as to enable him to receive a distribution for him. Those decisions proceed upon the theory that the taxpayer had the property rights in the trust corpus and, therefore, being the owner he could receive distribution thereof either *in propria personam* or by and through his agent. The instant case goes to ownership itself. In the absence of ownership, distribution can not control. Therefore, a decision based upon distribution is not decisive of a case where the criterion is acquisition of the ownership of the property.

ARGUMENT.

The will of R. J. Reynolds clearly provides that, until the age of 28, petitioner should have no right except to receive a specifically limited amount of income; that in the event petitioner died before attaining 28 years the property should belong to others; that only in the event petitioner attained the age of 28 would he become entitled [1] to the corpus and only at that age would the corpus belong to him.

The Supreme Court of North Carolina has construed the said will and has held that he did not and could not take any interest in the trust estate unless and until he reached age 28.[2]

The 1934 Act says that: "If the property was acquired by

[1] The ordinary, natural, popular, and received import and sense of the word "entitled" is shown by *Bouvier's Law Dictionary* thus: "Entitle. In its usual sense, to entitle is to give a right; therefore a person is said to be entitled to property when he has a right to it."

[2] *Reynolds* v. *Reynolds*, 208 N. C. 578, 597, discussed *infra*.

bequest, devise, or inheritance * * * the basis shall be the fair market value of *such property* at the time of *such acquisition.*"

The majority of the Board waved aside the plain language of the statute and held that the "time of such acquisition" means the date of decedent's death regardless of whether the taxpayer obtained any ownership or not. The Board bases this conclusion on an uncritical and obviously casual reading of a portion of a Committee Report of the Ways and Means Committee accompanying the 1934 Bill, which is quoted in the Board's opinion in the *Augustus* case, 40 B. T. A. 1201, at 1207.

When language is considered out of its context such error often arises. When the said Committee Report is considered in the light of its history, and in connection with the legislative and judicial history of the statutory provision, it will be seen that the quoted report does not support the Board's conclusion but negatives it. The Circuit Court so considered it, and reversed the Board.

Legislative History of Sec. 113 (a) (5).[1]

The provisions of sec. 113 (a) (5) of the 1934 Act were not novel. They had had a long history in prior acts. Sec. 113 (a) (5) is identical with the language which appeared as §202 (a) (3) of the 1921 Act, §204 (a) (5) of the 1924 Act, and §204 (a) (5) of the 1926 Act. These sections are set out in the *Appendix, infra*, p. 1. In the 1928 and 1932 Acts, however, this paragraph appeared in a wholly different form. A history of how this change came about, and of how the section was restored to its original form, is necessary for a clear understanding of the subject-matter.

During the period the Revenue Acts of 1918, 1921, 1924 and 1926 were in force, the sections in those Acts which were the same as sec. 113 (a) (5) of the 1934 Act, were construed by the Department. As early as 1920 the Department held in *O. D.* 727, 3 C. B. 53, that:

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[1] Orville Smith and Erwin N. Griswold, Esqrs., collaborated in this portion of the brief.

Where in a bequest of property the remaindermen have only a contingent interest prior to the death of the life tenant, the basis for determining gain or loss from a sale of such property by the remaindermen is its value as of the date of death *of the life tenant.*

The 1928 Act.

When the Revenue Act of 1928 was being formulated the Joint Committee on Internal Revenue Taxation made a Report, pursuant to the duty imposed on it by §1203 (c) (5) of the Revenue Act of 1926. This Report (House Document No. 139, 70th Congress, 1st Session, pp. 17–18; the relevant paragraphs of which are set out in the *Appendix, infra*, p. 3, contained a passage under a bold-faced heading: "*Basis for Gain or Loss on Sales by an Executor.*" The chief matter discussed was the then recent decision of the Court of Claims in *McKinney* v. *United States*, 62 C. Cls. 180 (1926), certiorari denied, 273 U. S. 716 (1926) where it had been held that gain or loss on a sale by an *executor* should be determined on the basis of the cost of the property to the decedent. This rule, the Joint Committee said, "is inconvenient." The old rule, that gain or loss on an *executor's* sale is measured by the value at the decedent's death, "seems preferable, and it is recommended that it be set forth in the statute." Immediately following this discussion, and under the same heading, the following paragraph was added:

> Section 204 (a) (5) [referring to the 1926 Act] prescribes the basis when the beneficiary sells the property as the value at the time of "acquisition." Some doubt has arisen as to what is meant by the date of acquisition. The "date of death" is recommended to make the basis certain and definite.

In accordance with this recommendation, the Revenue Bill of 1928, when it was introduced into the House, put §113 (a) (5) into the following form:

> If the property was acquired by bequest, devise, or

> inheritance, or by a decedent's estate from the decedent, the basis shall be the fair market value of such property *at the time of the death of the decedent.* (Italics supplied.)

The Report of the Ways and Means Committee accompanying this Bill (House Report No. 2, 70th Congress, 1st Session, p. 18) explained the change in these words:

> SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS—EXECUTOR'S SALE.
>
> In view of the decision of the Court of Claims in McKinney v. United States, it is desirable specifically to provide what basis shall be used in determining gain or loss on the sale of property by an estate. It is believed that the basis should be the value of the property on the date of the decedent's death, and this rule is incorporated in section 113 (a) (5).
>
> It is also provided, in the same paragraph, that the basis in case of a sale by a beneficiary shall be the value of the property on the date of the decedent's death.
>
> Under existing law, the basis in such a case is the value at the date of "acquisition," which is indefinite and has given rise to controversy. The value on the date of death affords an equitable and more readily determinable basis.

If the statute had been enacted in the form in which it appeared in the House Bill, and if it had continued in this form in the later Acts, it would clearly have led to the result reached by the Board below. Congress thus showed that it knew how to write statutory language which would require the conclusion that the Board has adopted in this case. *But Congress did not enact this language, and never has enacted it, or anything like it.* Instead, when the Bill went to the Senate, §113 (a) (5) was put into wholly different form. In the Bill, as reported to the Senate by the Senate Finance Committee, §113 (a) (5) was made to read as follows:

> If personal property was acquired by specific bequest, or if real property was acquired by general or specific devise

> or by intestacy, the basis shall be the fair market value of the property at the time of the death of the decedent. If the property was acquired by the decedent's estate from the decedent, the basis in the hands of the estate shall be the fair market value of the property at the time of the death of the decedent. In all other cases if the property was acquired either by will or by intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer.

The Report of the Senate Committee contains a long discussion of this change. Senate Report No. 960, 70th Congress, 1st Session, p. 26. This is set out in full in the *Appendix, infra*, pp. 4–5. Among other things, the Senate Committee said: "It appears that the House Bill is inadequate to take care of a number of situations which frequently arise." It pointed out that the value at the date of death *could not* be used in the case of property *purchased by the executor*, or "in the case of property transferred in contemplation of death where the donee sells the property while the donor is living." For these reasons, the Senate Committee proposed the much more detailed provision which it substituted for the section adopted by the House.

The provision recommended by the Senate Committee was adopted by the Senate. When the Bill went to Conference, the House receded. The Conference Report contains simply a restatement of the language in the Report of the Senate Committee. See House Report No. 1882, 70th Congress, 1st Session, p. 14 (Amendment No. 75) set out in the *Appendix, infra*, pp. 5–6. Thus the change in the law proposed by the Senate passed into the statute. It was enacted again in the same form in §113 (a) (5) of the Revenue Act of 1932.[1] Thus, the situation was that from 1921 to 1928 the statute contained a provision identical with that which is now before the court, while from 1928 to 1934, wholly different language was used in §113 (a) (5). *In making the change, however, Congress expressly*

[1] There was no discussion of this section in the Committee Reports on the 1932 Act.

rejected a form of the statute which would have made the date of death of the decedent the basic date in all cases.

In the Revenue Act of 1934, 113 (a) (5) was restored to its original, or pre-1928, form. The circumstances existing at the time of this change, and the details of the legislative history are obviously of great importance in determining the proper meaning, to be given to the restored language. These facts will be detailed below. In this connection, it should be recalled that the change made in 1928 was due, in large part, as the legislative history clearly shows, to the decision of the Court of Claims in *McKinney* v. *United States.*[1] *No specific reference was made then, or at any time, to the question of contingent bequests.*

The Rule of Brewster v. Gage.

Two years after the enactment of the Revenue Act of 1928, the Supreme Court decided the case of *Brewster* v. *Gage*, 280 U. S. 327 (1930). That case arose under the Revenue Acts of 1918 and 1921. The Revenue Act of 1921 contained a provision identical with those involved in this case, and the Revenue Act of 1918 was held to have the same effect. In *Brewster* v. *Gage*, the legatee took *an outright unqualified vested interest.* The question arose only because the legatee's actual receipt of the property in his possession was subject to the delay made necessary by the administration of the estate; but the beneficiary's right was subject to no contingency or condition. *The Court made this the basis of its decision* that the legatee took as his basis the value of the property at the decedent's death, saying (p. 334): "Petitioner's right later to have his share of the residue *vested immediately upon testator's death.* At that time petitioner became enriched by its worth which was directly related to and would increase or decline correspondingly with the value of the property." (Italics supplied.)

That decision obviously related only to a vested interest and

[1] The *McKinney* case was finally disapproved in *Hartley* v. *Commissioner*, 295 U. S. 216 (1935), where it was held, under the 1924 and 1926 Acts, that the basis on a sale by *the executor* was the value at the date of the decedent's death.

to one which was entirely unqualified, because that was the only sort of interest which was before the Court. No conditions or contingencies were there involved. *That case decided only one thing, viz: that where testator's death vests property immediately in the remainderman, such remainderman "acquires" the property at the moment of such vesting*—irrespective of the fact that he does not secure possession until later. That case did NOT hold that a *contingent* right in property, or a property right which was *not vested*, was one which was "acquired" at testator's death.

The Board's opinion herein states that the reasoning of *Brewster* v. *Gage* indicates that the purpose of the section was to make decedent's death the basic date regardless of the nature of the interest received. It is futile to argue what is palpably not so. *Brewster* v. *Gage* supports no such conclusion, and the Board is in error in stating that it does. On the contrary, *Brewster* v. *Gage* directly and positively negatives the Board's conclusion in the instant case. See dissenting opinions in *Augustus* and *Archbold* cases, *infra, Appendix*, pp. 13–15.

Uniform Decisions and Rulings on Vested and Contingent Interests.

When the Revenue Act of 1934 was under consideration, the Bureau of Internal Revenue had for fourteen years recognized the distinction between vested and contingent legacies in construing the word "acquired." *O. D.* 727, 3 C. B. 53, was published in 1920. It reads as follows:

> Where in a bequest of property the remaindermen have only a contingent interest prior to the death of the life tenant, the basis for determining gain or loss from a sale of such property by the remaindermen is its value as of the date of death of the life tenant.

Twelve years later, in 1932, the General Counsel of the Bureau of Internal Revenue considered the same question in an

exhaustive opinion,[1] and reached the same result. In *G. C. M.* 10260, C.B. XI-1, 79, 80, he said:

> * * * the position of this office has been that one who has a mere contingent interest does not "acquire" the property in question until his interest becomes vested. (O. D. 727, C. B. 3, 53; S. M. 4640, C. B. V-1, 60.) See also I. T. 1622, C. B. II-1, 135; S. O. 35, C. B. 3, 50.)

This was *after* the decision in *Brewster* v. *Gage*, which was specifically considered in the G. C. M. 10260, and which the Bureau obviously did not regard as establishing the construction of the word "acquired" so far as contingent interests were concerned. The practice was thus clear, consistent, and express at the time the Revenue Act of 1934 was enacted.

This same result had also been *uniformly* reached by the Board and the courts *at the time the Revenue Act of 1934 was under consideration.* In a number of cases it was held that a beneficiary did not "acquire" property when his interest was merely contingent. *Lane* v. *Corwin*, 63 F. (2d) 767 (C. C. A. 2, 1933), *cert. den.* 290 U. S. 644 (1933)—1928 Act,[2] *Pringle* v. *Commissioner*, 64 F. (2d) 863 (C. C. A. 9, 1933), *cert. den.* 290 U.S. 656 (1933)—1921 Act; *Becker* v. *Anchor Realty and Investment Co.*, 3 F. S. 22 (E. D. Mo. 1933) *aff'd*, 71 F. (2d) 355 (C. C. A. 8, 1934)—1928 Act; *Kalb* v. *Commissioner*, 15 B. T. A. 886 (1929)—1921 Act. The same rule was recognized in other cases decided before the enactment of the Revenue Act of 1934,

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[1] G. C. M. 10260 contains an exhaustive treatment of the whole subject matter, including the intent of Congress as evidenced by the Legislative History. It is too long for complete quotation but the salient portions are set forth *infra* in the *Appendix*, pp. 7-12.

[2] Cases decided under the 1928 Act are relevant in considering this question. Under that Act, as under the earlier Acts, the essential question was the proper meaning of the word "acquired." See *Twining* v. *Commissioner*, 83 F. (2d) 954 (C. C. A. 2, 1936), *cert den.*, 299 U. S. 578 (1936), involving the 1928 Act, where the court, in speaking of *Warner* v. *Commissioner*, 72 F. (2d) 225 (C. C. A. 2, 1934) *cert. den.*, 293 U. S. 620 (1934) said: "It is true that the Revenue Act there under consideration was the 1926 Act, but the problem of what was meant by the word "acquired" was no different from what it is under the 1928 Act."

where, however, the remainder was found to be vested. *Chandler* v. *Field*, 63 F. (2d) 13 (C. C. A. 1, 1933), *cert. den.*, 289 U. S. 758 (1933)—1926 Act; *Molter* v. *Commissioner*, 69 F. (2d) 7 (C. C. A. 7, Jan. 22, 1934)—1924 and 1926 Acts; *Hopkins* v. *Commissioner*, 69 F. (2d) 11 (C. C. A. 7, Jan. 26, 1934)—1924 and 1926 Acts; *Griscom* v. *Commissioner*, 22 B. T. A. 979 (1931)—1924 Act; *Kayser* v. *Commissioner*, 27 B. T. A. 816 (1933)—1924 Act; *Wright* v. *Commissioner*, 29 B. T. A. 1033 (Feb. 7, 1934)—1926 Act.[1]

There was thus written on the books for all to see a well-settled construction of the meaning of the word "acquired," when Congress was considering the Revenue Act of 1934. *It does not matter whether that construction was right or wrong. The important fact is that it existed and was uniform.* When Congress put back into the Revenue Act of 1934 the language of the earlier acts which had been given uniform meaning by the Bureau, the Board and the Courts, it must be deemed to have approved and adopted this construction. If it did not accept the meaning which the Bureau, the Board, and the Courts had repeatedly put on the words used, it would certainly have expressed the meaning it did intend. Instead, it used the very words which had been in the earlier statutes, and which had been recently and uniformly construed. There is thus clear occasion for the application of the well-settled and sound rule that when Congress puts into a statute words which have received a judicial construction, it must be presumed to have used the language in the sense which had previously been given to it. *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106, 115 (1939); *Hecht* v. *Malley*, 265 U. S. 144, 153 (1924); *Latimer* v. *United States*, 223 U. S. 501, 504 (1912).[2] See also *Electric Battery Co.* v. *Shimadzu*, 307 U. S. 5, 14 (1939).

The clarity and the uniformity of this construction may be

[1] The same construction has been uniformly followed in the decisions made after the enactment of the Revenue Act of 1934. See *Warner* v. *Commissioner*, 72 F. (2d) 225 (C. C. A. 2), July 23, 1934), *cert. den.* 293 U. S. 620 (1934)— 1926 Act; *Beers* v. *Commissioner*, 78 F. (2d) 447 (C. C. A. 3, 1935), *cert. den.* 296 U. S. 620 (1935)—1926 Act; *Forbes* v. *Commissioner*, 82 F. (2d) 204 (C. C. A. 1, 1936)—1928 Act; *Twining* v. *Commissioner*, 83 F. (2d) 954 (C. C. A. 2, 1936) *cert. den.* 299 U. S. 578 (1936)—1928 Act.

[2] See further discussion on this point, *infra* pp. 34–38.

illustrated by quotations from a few of the cases. Thus, in *Pringle* v. *Commissioner*, *supra*, it was held that a contingent interest was not acquired under the Revenue Act of 1921 until the termination of the preceding life estate. The Court said (pp. 864-865):

> It is not questioned that a person can not be said to have "acquired" property within the meaning of the Revenue Act, §202 (a) (3), *supra*, before he has some substantial ownership therein. If his interest is contingent upon the happening of some future event, until the happening of that contingency when his interest becomes vested, he has merely a possibility of acquiring an estate and can not be said to have any substantial ownership therein. *The rulings of the Department of Internal Revenue have consistently been to the effect that where one has merely a contingent interest in property he does not "acquire" that property until his interest becomes vested* * * *.
>
> Petitioners' interests in the property becoming vested on July 25, 1923, it was on that date that they "acquired" the property within the meaning of section 202 (a) (3) of the Revenue Act of 1921, *supra*, and the value of the property on that date should have been taken as the base for determining the gain or loss from the sale. * * *.
>
> *The cases of Brewster* v. *Gage*, 280 U. S. 327, *and Chandler* v. *Field* (C. C. A. 1), 63 F. (2d) 13, *are not controlling here. In each of those cases the interest of the taxpayer became vested immediately upon the death of the testator.* (Italics supplied.)

Similarly, in *Hopkins* v. *Commissioner*, *supra*, under the Revenue Acts of 1924 and 1926, the court said, after reviewing the earlier cases (p. 12):

> In all the cases, it was considered that the controlling factor was whether the interest created by the will was a vested or a contingent one, thereby determining whether the date of death or the date of distribution was to be taken as the basis for ascertaining gain or loss from the sale of the estate properties.

Perhaps the leading case decided before the enactment of the Revenue Act of 1934 was *Lane* v. *Corwin, supra.* That case involved the application of the Revenue Act of 1928 to a contingent interest. The court distinguished *Brewster* v. *Gage* in the following terms (p. 770):

> The Brewster Case presented a different question from that at bar. Here we have a different statutory provision. The reference to an executor's trust estate and the view that a residuary legatee's right to property at the death of the testator enriched him at that time can not be said to lead to a similar result where an express trust is set up by will even if a different statute was not involved. *The postponement of the legatee's actual dominion over the property during the duration of the executor's trust estate for the purpose of administering the estate is entirely different from the postponement of dominion, which might never be realized, by an express trust which might last for many years and prevent the taxpayer from ever obtaining the property outright.* * * *.
>
> Since the interest of the appellants was merely contingent and not vested, they should not be considered as having acquired the property at the time of the death of the testatrix * * *. (Italics supplied.)

The construction established by these cases has been consistently adhered to in the decisions which have come down since the enactment of the Revenue Act of 1934. Thus, in *Warner* v. *Commissioner, supra,* involving the Revenue Act of 1921, the Court referred to the fact that *Brewster* v. *Gage* did not deal with contingent interests, and said (p. 228):

> * * * we have preferred to assume, as other courts of the United States and the parties here have done, that a vesting of some recognized sort is necessary if the date of death, rather than the termination of the trust, is to be taken as the time when the interest of the taxpayer is "acquired."

This decision was cited with approval in *Twining* v. *Commissioner, supra,* where the court said (p. 955):

In *Warner* v. *Commissioner*, 72 F. (2d) 225, this court held that the test for determining when a remainder was "acquired," within the meaning of the Revenue Act, is whether it is vested or contingent. It is true that the revenue act there under consideration was the 1926 act, but the problem of what was meant by the word "acquired" was not different from what it is under the 1928 act. Literally, therefore, the first sentence of the above-quoted section 113 (a) (5) applies; the property "was acquired by general * * * devise." Had the remainder been contingent, then the last sentence of the section would have been applicable. Such was the case of *Lane* v. *Corwin*, 63 F. (2d) 767 (C. C. A. 2).

The same construction was also accepted by the Circuit Court of Appeals for the Third Circuit in two cases. In *Roebling* v. *Commissioner*, 78 F. (2d) 444 (C. C. A. 3, 1935), the court said (p. 446):

> The time of the "acquisition" of the property by the petitioner depends upon whether he received a vested or contingent interest under his father's will * * *.

And in *Beers* v. *Commissioner*, 78 F. (2d) 447 (C. C. A. 3, 1935), *cert. den.* 296 U. S. 620, the court said (p. 449):

> When did the taxpayer *acquire* the properties devised in trust, on the death of the testator or on conveyance to him by the trustee?
>
> * * * If a contingent remainder, he acquired them by conveyance at the end of the trust in 1925, and their value at that date controls the calculation.

These cases have been reviewed at this length because they show so plainly the clarity and uniformity of the construction which was adopted by the courts, a construction which was uniformly accepted—with no dissenting voice—when the Revenue Act of 1934 was under consideration. Indeed, we have altogether, in addition to the rulings of the Bureau and the decisions of the Board, eleven decisions of Circuit Courts of

Appeals accepting this construction—all after *Brewster* v. *Gage* was decided—*and with certiorari denied by the Supreme Court six times, in every case in which it was applied for.* It is difficult to see how the construction of the words could be more clearly and firmly established.

The Revenue Act of 1934.

With this background in mind, we may now consider the specific legislative history of the Revenue Act of 1934. The first public step in the formulation of that Act came on December 4, 1933, when a Subcommittee of the Committee on Ways and Means filed a Report proposing changes in the Revenue Act of 1932. With respect to §113 (a) (5) of the Revenue Act of 1932, the Subcommittee said (p. 17):

> Included within the phrase "all other cases" is personal property acquired by general or residuary bequest. Thus, where a trustee acquires personal property by general bequest, the basis of the property, on a sale by him, is the value at the time of distribution to him. The basis to the executor, in all cases, is the value of the property at the date of the decedent's death.
>
> Oftentimes, the executor and trustee under a will are one and the same person. Thus, in the case of a general bequest of personal property, he is in a position to make use of one basis of valuation or the other according to which will most benefit the estate. The trustee, of course, may use a later basis than the executor, and where it is desired to sell personal property subject to a trust during the period of administration, the executor-trustee may determine whether it would be most advantageous to sell as executor or as trustee. Where the personal property has increased in value in the hands of the executor, under a general bequest, the property may be distributed to the trustee, who may use the higher basis in computing gain or loss on the sale, thereby diminishing the taxable increment and greatly reducing or entirely avoiding the income tax.
>
> Section 113 (a) (5) of the Revenue Act of 1932 is a reenactment of a similar provision contained in the 1928 act. The change in the 1928 act was made because there was some doubt as to the meaning of the term "date of acquisi-

> tion," which was the term used under the Revenue Act of 1926. Since the 1928 act was passed, the Supreme Court has defined "the date of acquisition" to mean the date of death in the case of all property passing by bequest, devise, and inheritance, *whether real or personal.* (*Brewster* v. *Gage*, 280 U. S. 327.) Your subcommittee recommend that section 113 (a) (5) of the Revenue Act of 1932 be changed to conform to the language contained in the Revenue Act of 1926, so that a uniform basis rule may be required in the case of property passing at death, *whether real or personal.* (Italics supplied.)

This Report makes it apparent that what the Subcommittee had in mind was the different rules of basis which might be applicable to substantially identical interests acquired under the same will, *depending upon whether the property was real or personal.* It is easy to read the phrase "uniform basic rule" in the Report with complete and unwarranted generality of application. But that is not an accurate reading of the Report. On the contrary, the Report itself clearly shows that the uniformity to which the Subcommittee was referring was uniformity with respect to vested interests *as between realty and personalty*, and so that the quite unwarranted option available to *executors* under the 1928 and 1932 Acts would no longer be available.

That Congress did not have in mind at all the question of contingent interests is shown by the legislative and judicial history which has just been detailed. That the Treasury Department had no idea that the proposed restoration of the pre-1928 language in the statute was going to remove all problems was made immediately apparent. Shortly after the Report of the Subcommittee was made, the Acting Secretary of the Treasury filed a printed Statement relating to the Subcommittee's Report. This Statement contains the following passage on the point under consideration (p. 16):

> The Treasury submits that the proposed amendment to section 113 (a) (5) presents no improvement over the present statute, and therefore, in accordance with the policy that no change should be made unless it results in a

material improvement of the statute, the Department believes that the amendment should not be adopted.

The understanding of the Treasury was clearly confirmed at the Hearings before the Committee on Ways and Means. At those Hearings, the Treasury was represented by Mr. Roswell Magill. The proposed amendment to §113 (a) (5) was specifically considered. Mr. Magill first presented the Treasury's view as expressed in the Statement of the Acting Secretary of the Treasury. The Hearings then continue as follows (pp. 144–145):

> Mr. Magill. * * * I take it that the subcommittee and the Treasury are in agreement as to what the basis should be in these cases. The subcommittee report suggests that under decisions of the Supreme Court the basis would be, in the absence of a statutory provision, what the statutory provision provides, and hence that you will simplify the law by taking out the express statutory provision. We are not clear that that would be true *because the decision covers only one or two points*, whereas the subdivision covers several, and there may be some doubts which would be created by such a change that are settled by the present wording.
>
> Mr. Cooper. I think the object of the subcommittee was to try to get a uniform rule.
>
> Mr. Magill. Yes.
>
> Mr. Cooper: That would apply all the way through.
>
> Mr. Magill. The Treasury is in entire agreement with you as to your purpose. The only question is whether that would be accomplished, if you did not have the specific provision. Your report, I take, quite fully states the situation on that point, and I do not know of any other evidence to submit than what you already have in your report.
>
> Mr. Hill. I think it would be very well at this point to have Mr. Stam state the reason for this recommendation here in the subcommittee's report.
>
> Mr. Colin F. Stam, counsel, Joint Committee on Internal Revenue Taxation. That is 16. There were some cases where the *executor might act as trustee*, and he would have his option as to what basis he could take in case of

property passing by general bequest. In other words, under the 1932 act, if he made distribution to himself as trustee, he would take as the basis the value of the property at the date of distribution. On the other hand, *if he sold the property himself as executor*, he would take as the basis the value of the property at the date of death. So he would have a choice there between those two, and we thought that was unfair; that we ought to have one definite, fixed date.

Mr. Magill. We would agree with you on that.

Mr. Stam. Then there is another point, where the *executor* buys property and does not distribute the original property to the distributee, but buys other property. Under the 1932 rule the distributees would take the basis at the date of distribution rather than the cost to the executor of that new property.

Mr. Magill. Which is not correct.

Mr. Stam. We thought it was a bad rule, because the appreciation has escaped taxation entirely.

Mr. Magill. That is true. I quite agree with you on both cases. I think the question simply is whether it would be better to put in some specific language which would cover those cases, or whether you can obtain the results you want by taking out all of the present provisions on the subject. (Italics supplied.)

It was following this Hearing that the Ways and Means Committee made its Report which is merely a verbatim transcript of the Report of the Subcommittee, and thus adds little, if anything, to the legislative picture. The House adopted the Bill as proposed by its Committee. The only change made by the Senate was the addition of the words "or by the decedent's estate from the decedent," which appear in the final enactment. The Senate Committee Report again simply repeats the language of the Subcommittee's Report.

The Proper Construction of §113 (a) (5) of the 1934 Act.

This examination of the legislative history shows, particularly in the light of the background previously outlined, that the main motive for reenacting the pre-1928 language was to

prevent an executor of an estate from having a profitable choice of basis when the executor was also the trustee of a trust set up by the will of the decedent, and also to take care of the situation where an executor buys property and distributes it to a legatee. The "uniform rule" mentioned by Mr. Cooper in the Hearings, and the "uniform basis rule" in the Committee Report refer to these problems, *and to the divergent rules* prescribed under the 1928 and 1932 Acts *for vested interests, as between real and personal property. There is no mention of the treatment of contingent interests, no complaint with the practice of the Bureau, or the decisions of the Board and the Courts. No thought is suggested, either in the Hearings or in the Committee Reports, that the construction made so uniformly by the Bureau, the Board, and the Courts, with respect to contingent interests, should be changed. The attention of Congress was directed to the divergent basis rules which existed in the case of interests which were clearly vested.* What was in mind was a *uniform rule for vested interests.* This is emphasized by the reference to *Brewster* v. *Gage*, which, as has been pointed out, involved a clearly vested interest. It is also emphasized by the words "*whether real or personal,*" which appear twice in all three of the Reports.

This conclusion is well summarized in the dissenting opinion in the *Augustus* case in the Board:

> It seems to me that the reports to which the majority opinion refer went no further than to make plain that the purpose of the language was to adopt the construction which the Supreme Court of the United States had put upon similar language in *Brewster* v. *Gage*. I think that the court in *Pringle* v. *Commissioner*, makes clear that *Brewster* v. *Gage* did not decide the question we have in the instant case.

The quotation from the *Pringle* case which is thus referred to has already been set out at p. 15 above.

There is not a syllable in the Hearings, Committee Reports, or elsewhere, to indicate that Congress contemplated that the rule which it was establishing would in any way affect the

already well-settled rule as to the basis of contingent interests. On the contrary, it deliberately adopted language which had at that time been clearly construed to draw a distinction between vested and contingent interests, without intimating even by inference or innuendo that it intended to abandon this distinction. The Committee Report which the Board below found to be "conclusive" in fact furnishes no basis for the conclusion that Congress intended the wholly incongruous and illogical result that the pre-1928 language, without any change of any sort, would, when restored to the statute, take on a meaning wholly different from that which it had uniformly been construed to have.

Such a *tour de force* should not be ascribed to the Congress which used the simple, well-understood, words of this statute. If Congress had intended the result for which the Treasury now contends, it would have enacted the clear and simple rule of the House Bill of 1928 (see pp. 8–9, *supra*). But this language was rejected by Congress in 1928, and it was not put into the Bill in 1934. *Congress has never enacted it.* The position of the Treasury here that the pre-1928 language restored to the 1934 Act has the same meaning as the never-used language of the discarded 1928 Bill. Such a construction can only be reached by ignoring the words actually used by Congress, and the clear lesson from the history of the statute.

There is a concluding piece of evidence on the meaning of the 1934 Act which seems to be of great importance. It will be recalled that Mr. Magill, later Under Secretary of the Treasury, was the representative of the Treasury at the Hearings on the 1934 Act. In 1936, two years after the statute was passed, he published his book on "Taxable Income.". In this book, he discussed the present problem in the following language (pp. 388–389):

> The courts, however, have clung tenaciously to the vested-contingent distinction * * *. In its recent regulations, however, the Treasury has abandoned the distinction and declared that hereafter the basis shall be the value as of the date of the creation of the remainder in all cases. In

> view of the court decisions in the cases cited, the effectiveness of this administrative action is questionable. If there is merit in the argument that Congress, by reenacting prior statutes which have been uniformly interpreted by the Treasury, has given such interpretations the force of law, then *it should take congressional action to change the interpretation.* (Italics supplied.)

The Treasury's own representative in the drafting of the statute thus shows his understanding that the restoration of the pre-1928 language did not carry with it the change of meaning which the Board has given to it. Certainly if Congress had intended anything else, it would have made its meaning clear and would have written a Committee Report which would have dealt with this specific problem, and not merely with questions arising as to unqualifiedly vested testamentary gifts.

In the light of the uniform construction which had been given to the words which Congress used in 1934, it can not be fairly said that the statute then enacted was in any way ambiguous. Indeed, the meaning which had been given to the words in question was simply the natural meaning of the words used. The word "acquired" is not a word of vague or shadowy meaning. It is defined in New Century Dictionary and in Webster's New International Dictionary, 2d edition, published in 1934, as meaning "to get as one's own."[1] This definition has been authoritatively approved by the Supreme Court in *Helvering* v. *San Joaquin Fruit and Investment Co.*, 297 U. S. 496, 499 (1936), where the Court had to consider the meaning of the word "acquired" as used in the very sections of the earlier Revenue Acts from which the present §113 was derived. The Court said (p. 499):

> The word "acquired" is not a term of art in the law of property but one in common use. The plain import of the

[1] Bouvier's Law Dictionary: "To make property one's own. It is regularly applied to a permanent acquisition."

word is "obtained as one's own." Language used in tax statutes should be read in the ordinary and natural sense.[1]

It can hardly be said that a person has obtained property as his own when he has a mere hope, expectancy or possibility of obtaining it. This is clearly shown by the fact that if the petitioner's interest was contingent and he had died before the happening of the contingency (viz., before reaching the age of 28), no part of the property would have been subject to estate tax in the petitioner's estate under Treasury Regulations of long standing;[2] this is in sharp contrast with the decision below that the petitioner "acquired" the property on the death of his father.

It will be remembered that the instant will provided that "*until*" the respondent attained 28 years he should have only certain income, and that "*when*" he became 28 he "*shall become entitled to*" (R. 18) a share of the trust corpus. In applying the rule of the *San Joaquin* case, *Deputy* v. *Du Pont*, the *Maillard* case, and the *Old Colony* case, all *supra*, we turn to *Bouvier's Law Dictionary* to find the ordinary, natural, popular, and received import and sense of the word "entitled." That authority gives the following: "*Entitle. In its usual sense, to entitle is to give a right; therefore a person is said to be entitled to property when he has a right to it.*"

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[1] In the recent case of *Deputy* v. *Du Pont*, 308 U. S. 488, 493, the Court (per Mr. Justice Douglas) said: "And when it comes to construction of the statutory provision * * * the general rule that 'popular or received import of words furnishes the general rule for the interpretation of public laws.' *Maillard* v. *Lawrence*, 16 How. (U. S.) 251, 261, is applicable."

The most complete exposition of the rule is in *Old Colony R. Co.* v. *Com'r.*, 284 U. S. 552, 560:

> The rule which should be applied is established by many decisions. "The legislature must be presumed to use words in their known and ordinary signification." * * * "The popular or received import of words furnishes the general rule for the interpretation of public laws." * * * The plain, obvious and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and ingenuity and study of an acute and powerful intellect would discover." * * *

[2] *Cf.* Regulations 80 (1937 ed.) Art. 13: "Nothing should be included, however, on account of a contingent remainder in the case the contingency does not happen in the lifetime of the decedent, and the interest consequently lapses at his death."

By his new regulation petitioner says that "all titles" must relate back to the death of the decedent, regardless of the nature of the interest when decedent died. The regulation purports to rely upon *Brewster* v. *Gage.* But neither *Brewster* v. *Gage* nor the statute give any support to such a theory of relation-back; and that theory may not be used to change the settled meaning of a word not in any sense a word of art. In *Brewster* v. *Gage* the remainder interest was vested at decedent's death. The enjoyment and possession was merely postponed. Therefore, the receipt of possession and enjoyment merely related back to the vesting of the property right. However, that does not mean that the vesting of an estate shall relate back to an arbitrary date prior to its existence.

In the *San Joaquin Fruit & Inv. Co., supra,* the Supreme Court, after using the language just above quoted, said:

> *The fiction of relation,* indulged in to defeat those dealing with the legal title with knowledge of the option, *can give no aid in solving the question of the time of the optionee's acquirement of property under a statute taxing gain upon a subsequent sale.* (Italics supplied.)

In the instant case the issue involves the time of acquisition of certain securities. It is true the petitioner came into possession and enjoyment of them at April 4, 1934. However, it is equally true that the Supreme Court of North Carolina says that until April 4, 1934, he did not become entitled (i. e., he did not have any right) to any interest in the trust property, and that unless and until he reached 28 he had no right (i. e., was not entitled) to anything except to receive certain income if, as, or when it became payable to him. In other words the date of acquisition of title coincided with the date of receipt of possession and enjoyment. Therefore, petitioner's property right was not acquired until April 4, 1934.

One final point firmly buttresses all that has been said before. When Congress legislates, it is the *statute* which is the law, and it is the meaning of the *statute* which must be sought. Congress can not legislate by committee report. On the contrary, com-

mittee reports are only relevant as they shed light on an ambiguous statute; a committee report can not be relied on to import into a statute an ambiguity which is not there. Even if the committee reports involved here were themselves clear, specific, and unambiguous, they would furnish no basis, therefore, for changing the meaning of the words which Congress actually used in the statute itself. The rule stated in *Helvering* v. *City Bank Farmers Trust Co.*, 296 U. S. 85, 89 (1935), seems squarely applicable here:

> We are not at liberty to construe language so plain as to need no construction, or to refer to Committee reports where there can be no doubt of the meaning of the words used.

Here, if the committee reports are disregarded, it seems wholly fair to say, in the light of the uniform departmental and judicial construction, that "there can be no doubt of the meaning of the words used." Congress can not use "gray" in a statute and make it mean "black" by saying so in a committee report. And this is *a fortiori* true where, as here, the committee reports contain nothing which deals in any way specifically with contingent interests such as those here involved, so as to show any intention that the statutory words should mean anything different from what they had uniformly been construed to mean in the earlier Acts.

The effort of the Commissioner to make the words of the statute mean what they clearly did not mean when they were put back into the statute in 1934, would seem to fail as a piece of wishful boot-strap lifting. The situation is analogous to that involved in the recent decision of the Supreme Court in *Helvering* v. *Wood*, 309 U. S. 344. In that case the Court struck down an attempt by the Commissioner to extend §166 of the statute beyond the meaning of the words actually used by Congress. The Court, per Mr. Justice Douglas, used language which seems directly applicable here:

> Whether as a matter of policy such nice distinctions should be perpetuated in a tax law * * * is not for us. We have only the responsibility of carrying out the Congressional mandate * * *. The legislative history corroborates this conclusion.

All of the foregoing legislative history clearly shows that when in the 1934 Act Congress reenacted the identical provisions of prior revenue acts, Congress did not mean to prescribe the same rule regardless of whether the legacy was obtained as one's own or was merely expectant, hoped-for, and without factual substance. *Patently Congress did not say so, and it is clear that Congress did not intend so.*

THE STATE LAW IS BINDING AS THE RULE OF PROPERTY.

It is established that the rule of property and interpretation of wills is concluded by the State law.

In *Blair* v. *Com'r,* 300 U. S. 5, the precise question was before the Court. The Court said (pp. 9–10):

> The supervening decision of the state court interpreting that law in direct relation to this trust can not justly be ignored in the present proceeding so far as it is found that the local law is determinative of any material point in controversy.[1]
>
> The question of the validity of the assignments is a question of local law. The donor was a resident of Illinois and his disposition of the property in that State was subject to its law. *By that law the character of the trust, the nature and extent of the interest of the beneficiary,* and the power of the beneficiary to assign that interest in whole or in part, *are to be determined. The decision of the state court upon these questions is final.*[2] * * * To derogate from the

[1] Citing *Freuler* v. *Helvering,* 291 U. S. 35; *Hubbell* v. *Helvering,* 70 F. (2d) 668.

[2] Citing: *Spindle* v. *Shreve,* 111 U. S. 542, 547, 548; *Uterhart* v. *United States,* 240 U. S. 598, 603; *Poe* v. *Seaborn,* 282 U. S. 101, 110; *Freuler* v. *Helvering,* 291 U. S. 35, 45.

authority of that conclusion and of the decree it commanded, so far as the question is one of state law, would be wholly unwarranted in the exercise of federal jurisdiction.

In the face of this ruling of the state court it is not open to the Government to argue that the trust "was, under the Illinois law, a spendthrift trust." The point of the argument is that, the trust being of that character, the state law barred the voluntary alienation by the beneficiary of his interest. The state court held precisely the contrary. The ruling also determines the validity of the assignment by the beneficiary of parts of his interest. That question was necessarily presented and expressly decided. (Italics supplied.)

In addition to the authorities cited above, see also:

Sharp v. *Com'r*, 303 U. S. 624 (1938);
Erie R. Co. v. *Tompkins*, 304 U. S. 64 (1938);

The construction of the Reynolds will is to be determined according to the law of North Carolina, and the statement of that law by the North Carolina courts is conclusive and binding.

Decisions of the Courts of North Carolina defining the interest of petitioner herein.

The writ in the instant case relates only to the federal question and, therefore, all dispute is eliminated as to the validity and application of the decision reported in *Reynolds* v. *Reynolds*, 208 N. C. 578. We have therefore only to examine that decision to see what was the nature and extent of respondent's rights and interests under his father's will.[1]

[1] For a summary of the factual and jurisdictional findings of the North Carolina Courts in *Reynolds* v. *Reynolds, supra*, the attention of this Court is respectfully invited to "Memorandum for the Respondent" filed in the instant cause in respect of the petition for certiorari filed herein.

In the decision in *Reynolds* v. *Reynolds, supra,*[1] the findings and decision of the lower court were affirmed, and it was set out therein that in a former suit the instant respondent had contended that he had acquired and was the owner of the securities comprising the trust corpus and that, as such owner, he was entitled to include in his annual statement the income received from the trust estate as earnings of securities belonging to him or in which he had an interest. The Supreme Court of North Carolina had decided that issue adversely to respondent's contentions (201 N. C. 267), and in the decision affirmed in *Reynolds* v. *Reynolds, supra,* it is thus recited:

> That one of the issues raised in said case * * * was the following:
>
> 2. Whether if the contention of the trustee is correct, the plaintiff is not entitled to include in his annual statement income received from his share of the trust estates of his father * * * *as "earnings* of money, *stocks or bonds owned by him."*
>
> That * * * in said cause * * * *the argument was squarely presented to the Court, that the children of R. J. Reynolds owned vested interests in his estate with a period of postponed possession* until they should respectively attain the age of 28 years, *subject only to be divested by death* before arriving at that age, *which argument was considered by the court and expressly rejected* as appears in its opinion heretofore referred to. * * * Therefore, the Court holds as a matter of law that the *children of R. J. Reynolds did not receive any vested interest* in the trust estates of * * * their father * * *; that by the will of their father *they had only* the right to receive, if, as and when payable, certain income from said estate, *and the possibility of receiving* property *vested both in interest and possession if, as, and when they should respectively attain the age of 28 years;* * * * (Italics supplied.)

[1] See ¶ 35 of Judgment and Decree, pp. 664–666 of Exhibit A (and also pp. 721–723 of Exhibit B) referred to in the Stipulation at R. 56, and in footnote at bottom of p. 3 of petitioner's brief.

In the same decision[1] the Court said:

> (a) The will of R. J. Reynolds did not bequeath or devise to Zachary Smith Reynolds any vested interest or share in the trust estate (or any part thereof) created and established by said will. A proper construction and interpretation of said will shows that no part of the trust estate established thereby, and none of the accumulated income thereof, would have vested in the said Zachary Smith Reynolds unless and until he arrived at the age of twenty-eight years. Until the said Zachary Smith Reynolds arrived at said age of twenty-eight years, **the only interest which he had** in the trust estate established by said will (or any part thereof) **was to receive such payment from the income thereof,** if, as, and when payable to him, under the terms of said will. Consequently, upon the death of the said Zachary Smith Reynolds, prior to reaching the age of twenty-one years, no part of said trust estate (either corpus or income) was transferred from him to any one.

From the foregoing we see that the North Carolina Courts have specifically interpreted this will and have decided and held:

1. The *only* right which this respondent had under his father's will was to receive certain payments of income if, as, and when payable to him;
2. Beside this right to receive certain restricted income all that respondent had was the possibility (if, as, and when he should attain the age of 28) to receive property which (if, as, and when he should attain the age of 28) he would then obtain both in interest and in possession;
3. Prior to reaching the age of 21 respondent had *no part* of said trust estate (either corpus or income) which he could transmit to any one;

[1] See ¶ 60 and 60 (a) of Judgment & Decree, pp. 680–681 of Exhibit A (also p. 737 of Exhibit B) above referred to. All of the findings, statement, rulings and holdings of the Superior Court were recited *in haec verba* by the Supreme Court in its decision affirming the lower court.

4. Respondent did *not* have an interest which was vested but subject to a period of postponed possession;
5. Respondent did *not* have an interest which was vested but subject to defeasance or divestment by death prior to age 28;
6. Respondent could not obtain, receive, *or acquire*, any *interest* or any *possession* unless and until he should have attained 28 years.
7. The will did not bequeath or devise to respondent *any interest or any share in* the trust estate (or any part thereof).
8. *No part* of the trust estate (and *none of the accumulated income* thereof) *would* have vested in him *unless* he attained the age of 28, and *until* he attained the age of 28.

Petitioner argues (or rather assumes arguendo) that respondent had an interest (albeit a contingent interest) in the trust corpus. Obviously such an assumption is taken for the purpose of arguing that if this Court has, under any and all circumstances, abolished all distinction between vested and contingent interests, then a contingent interest in this respondent would bring the same result as if he had a completely vested interest.

But petitioner's assumption is without any basis. A careful study of the foregoing decision of the North Carolina courts fails to disclose even a suggestion that respondent has any interest or estate whatsoever in the trust corpus—contingent or otherwise. On the contrary, every sentence of the State decision bristles with negatives. The Courts down there stated, in as many different ways as there was of saying it, that respondent *did not have any interest or estate whatsoever* in the trust estate (or of any part thereof), or in any of the accumulated income; that he did not, and could not, have acquired any such interest unless and until he reached the age of 28; that when he reached 28 his interest and his possession would both be acquired at the same time; and that unless and until that time arrived all the respondent had was a right to some income and a possibility of receiving property if, as, and when he should attain the age of 28.

The Court was very careful to make it clear that respondent was devoid of an interest. If a person is devoid of all interest in an estate, he can not possibly be said to have "acquired" the whole of that estate.

The decisions of the Courts of North Carolina firmly establish that respondent did not "acquire" the trust estate at his father's death.

It is equally clear that the North Carolina decisions likewise dispose of the question as to the securities bought by the Trustee with the income accumulated in the trust. The North Carolina decisions decide and hold that "none of the accumulated income *would have* vested" in respondent "*unless and until*" he arrived at the age of 28. Words could not be clearer than that: They mean that not only the accumulated income *did not belong* to respondent, but that *it could not* belong to him "unless" and "until" the time came when he might acquire an interest both vested and in possession, simultaneously.

Now it follows, as night follows the day, that if the accumulated income did not belong to respondent, it certainly could not become his merely because the Trustee went out and spent it. If that accumulated income was not his (and the North Carolina Courts say it was not his), then when that accumulated income was turned into securities, those securities did not become his either.

It is equally true that if the securities owned by his father were not his, the exchange of these securities for other securities would not make the latter securities belong to respondent. This is no less true in case the earlier securities were sold and their proceeds used to buy new securities.

The proposition that a person can "acquire" property before he can own it or have an interest in it, or have a right to it, resolves itself into a patent absurdity when one considers the problem of when a posthumous child, or an unborn beneficiary, would "acquire." No one but a person *in esse* can acquire or own anything. Yet it is just as sensible to argue that a person "acquired" property (i. e. obtained the ownership thereof as his own) 16 years before his birth, as it is to argue that he

"acquired" a similar property in which the law says he had no interest, estate, ownership, right, or possession.

The law of North Carolina [1] is binding upon all Federal Courts and tribunals, and is determinative of this controversy.

A BUREAU REGULATION CAN NOT ALTER OR AMEND THE LAW, AND ONE WHICH ATTEMPTS TO DO SO IS VOID.

For many years the statute provided that the basic date for property, acquired as in this case, should be the value of the property at the time of such acquisition. The law so stood in the Revenue Acts of 1918, 1921, 1924, and 1926. The Regulations promulgated under all those acts provided the same test.

The Supreme Court in *Brewster* v. *Gage* said that where, upon testator's death, a beneficiary acquires a *vested* interest, the basic date is the date of testator's death.

A large number of Circuit Court and Board decisions held that the decision in *Brewster* v. *Gage* applied only to those cases in which a "vested" estate was acquired at testator's death; *and that where the interest acquired at testator's death was a mere contingent interest, the acquisition did not take place at the date of testator's death, but took place at the date on which the beneficiary acquired a substantial ownership of the property.*

The General Counsel ruled that where the interest acquired at testator's death was not a substantial interest, the basic date was not the date of testator's death but was the date on which the beneficiary acquired a substantial ownership of the trust corpus; and that the Departmental Regulations so interpreted and construed the statute.

The Supreme Court in *Brewster* v. *Gage* said that the Regulations promulgated under sec. 202 (a) of the 1918 Act, sec. 202 (a) (3) of the 1921 Act, sec. 204 (a) (5) of the 1924 Act, and sec.

[1] The decision of the Supreme Court in *Reynolds* v. *Reynolds*, *supra*, is in accord with, and supported by, more than a century of consistent precedents in its decisions. *Kent* v. *Watson*, 17 N. C. (2 Dev. Eq.) 366; *Giles* v. *Frank*, 17 N. C. 2 Dev. Eq.) 521; *Gill* v. *Weaver*, 21 N. C. (L. Dev. & Bat.) 41; *Anderson* v. *Felton*, 36 N. C. (1 Ire. Eq.) 55; *Whitesides* v. *Cooper*, 115 N. C. 570; *Freeman* v. *Freeman*, 141 N. C. 97; *McRae* v. *Commerce Union Trust Co.*, 199 N. C. 714.

204 (a) (5) of the 1926 Act, were reasonable and in accordance with the letter and spirit of the statute; that a reversal of that construction would produce inconvenience and inequality; that the substantial reenactment in later acts in light of such construction is persuasive evidence of legislative approval of the regulations; that such subsequent legislation confirmed and carried forward the policy of such enactments as interpreted by said regulations, and that the said regulations will not be disturbed.

It was in light of all the foregoing that Congress reenacted the exact provisions of the 1921, 1924 and 1926 Acts in sec. 113 (a) (5) of the 1934 Act.

"Possible doubts as to the proper construction of the language used [in a statute] should be resolved in light of its administrative and legislative history." *McCaughn* v. *Hershey Chocolate Co.*, 283 U. S. 488, 492.

"Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law." *Com'r* v. *Winmill*, 305 U. S. 79.

"And again, when, for a considerable time, a statute notoriously has received a construction in practice from those whose duty it is to carry it out, *and afterwards is reenacted in the same words*, it may be presumed that the construction is satisfactory to the legislature, unless plainly erroneous, since otherwise naturally the words would have been changed." (Italics supplied.) *Copper Queen Consol. Min. Co.* v. *Arizona*, 206 U. S. 474.

"And we have decided that the reenactment by Congress, without change, of a statute which had previously received long-continued executive construction, is an adoption by Congress of such construction." *United States* v. *Cerecedo Hermanos y. Compania*, 209 U. S. 337.

"If the legislative body had considered the Treasury interpretation erroneous it would have amended the section. Its failure so to do requires the conclusion that the regulation was

not inconsistent with the intent of the statute * * *." *Massachusetts Mutual L. Ins. Co.* v. *United States*, 288 U. S. 269.

"This construction of those terms has been adhered to in the Internal Revenue Bureau for about ten years and it ought not to be disturbed now unless it be plainly wrong."[1] *Universal Battery Co.* v. *United States*, 281 U. S. 580.

To the same effect:

United States v. *Alabama Great Southern R. Co.*, 142 U. S. 615;
Murphy Oil Co. v. *Burnet*, 287 U. S. 299, 322;
National Lead Co. v. *United States*, 252 U. S. 140;
United States v. *Farrar*, 281 U. S. 624;
United States v. *Jackson*, 280 U. S. 183;
Fawcus Machine Co. v. *United States*, 282 U. S. 375;
Old Colony R. Co. v. *Com'r*, 284 U. S. 552;
Helvering v. *Bliss*, 293 U. S. 144;
Old Mission P. Cement Co. v. *Helvering*, 293 U. S. 289;
Koshland v. *Helvering*, 298 U. S. 441;
Commissioner v. *R. J. Reynolds Tob. Co.*, 306 U. S. 110.

The Revenue Act of 1934 was enacted in light of the foregoing, and the rule is controlling here. The rule has thus become "embedded in the law" so that it would take an Act of Congress to change it. *E. R. Squibb & Sons* v. *Com'r.*, 98 F. (2d) 69.

In 1935 the Commissioner purported to change the law by promulgating a regulation (Reg. 86, art. 113 (a) (5) (b)) to the effect that the acquisition of an interest or title in property relates back to date of decedent's death, regardless of when such acquisition in reality takes place.

But the Commissioner can not thus make a fact something which it is not. Even the Congress can not do so. *Schlesinger*

[1] It can not be argued here that the regulations were plainly wrong because the Court said in *Brewster* v. *Gage* that they were proper regulations and had the force and effect of law.

v. *Wisconsin,* 270 U. S. 230; *Heiner* v. *Donnan,* 285 U. S. 312. "Treasury regulations can add nothing to income as defined by Congress." *Blatt* v. *United States,* 305 U. S. 267. A Treasury regulation "can not here be construed to create income or dividends in a case where none otherwise existed when the facts are measured by the statute. Income can not be created by fiat alone." *Taplin* v. *Com'r,* 41 F. (2d) 454, 456. "A regulation to be valid must be reasonable and must be consistent with law." *Commissioner* v. *Van Vorst,* 59 F. (2d) 677, 679, affirming 22 B. T. A. 632; *Morris-Poston Coal Co.* v. *Com'r,* 42 F. (2d) 620, 621.

The new regulation is not consistent with law or with fact. It attempts to say that the petitioner acquired the trust property when he did not acquire it. Such a distortion of facts and legal principles deprives the statute (and the decisions) of any meaning, and gives the Commissioner "a power to re-write the statute more broadly than Congress obviously intended." *Rovensky,* 37 B. T. A. 702.

It is clear from all the foregoing that the word "acquisition" had a well recognized judicial meaning which Congress adopted in the 1934 Act, and which could not be changed by a departmental regulation.

> The power of an administrative officer or board to administer a federal statute and to prescribe rules and regulations to that end is not the power to make law—for no such power can be delegated by Congress—but the power to adopt regulations to carry into effect the will of Congress *as expressed by the statute.* A regulation which does not do this, but operates to create a rule out of harmony with the statute, is a mere nullity. *Manhattan General Equipment Co.,* 297 U. S. 129.

In view of the established judicial and departmental construction placed upon the word, and in view of the absence of any intention of Congress to change that construction, and in view of the absence of any controlling reason for assuming that Congress intended such a change, it is submitted that the attempted change of the established meaning of the word

"acquisition" by a regulation is invalid, ineffective, and a mere nullity.

An invalid regulation receives no sanction by statutory reenactments. It will be remembered that the 1934 Act changed the law as it had existed *only under the 1928 and 1932 Acts. It did not change the law from what it had been under the 1926 and previous Acts. The Committee Reports state that it was the purpose to restore the law as it had been under the 1926 and previous acts.* In enacting the 1934 Act, Congress adopted the construction which had been put upon all the previous acts. *G. C. M. 10,260* was two years old when the 1934 Act was enacted, and was promulgated two years after *Brewster* v. *Gage* was handed down. It was promulgated in the light of many Circuit Court and Board decisions, and the 1934 Act was enacted in light of G. C. M. 10,260 and of all those judicial decisions.

There is no more clearly established rule than that if a regulation is not sound, no subsequent re-enactment of a statute can give it any validity whatsoever. *Koshland* v. *Helvering*, 298 U. S. 441; *Helvering* v. *Gowran*, 302 U. S. 238, 242; *Blatt Co.* v. *U. S.*, 305 U. S. 267; *Woolworth Co.* v. *U. S.*, 91 F. (2d) 973; *Com'r* v. *Shattuck*, 97 F. (2d) 790; *Helvering* v. *Kimberly*, 97 F. (2d) 433. Cf. *Helvering* v. *R. J. Reynolds Tob. Co.*, 306 U. S. 110.

Regulations 86 do not apply to this case anyway.

As we have shown, Regulations 86, Art. 115 (a) (5)-1, are totally incompatible with the statute and the intent of Congress, and constitute an attempted act of legislation on the part of the Department. However, even the Regulations do not go so far as to say that the date of decedent's death is basic unless the taxpayer acquired *some interest or estate* in the trust corpus when decedent died. The Regulations include contingent estates, conditional estates, and about every kind of estate or interest that could be thought up. But, whether inadvertently or intentionally, there was a complete failure to specify that even though taxpayer acquired no interest of any kind what-

soever, the date of decedent's death was basic anyway. That omission removes the instant case from the ambit of the Regulations, since under the laws of North Carolina he did not obtain or acquire any interest or estate whatsoever at his father's death.

In no event should the changed Regulation be applied retroactively to years prior to its promulgation.

Regulations 86 were approved by the Secretary on February 11, 1935, and were later promulgated. Thus the Regulations on which the petitioner now relies were not even in existence in the year in which the instant transactions took place. Therefore, under no circumstances should those regulations be retroactively applied to a year prior to the existence of such regulations, and to a year *during all of which the opposite rule stood published to the world* as the Departmental rule of construction and interpretation.

This precise point was recently decided by this Court in *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110, 115. This Court covered this point completely, saying:

> Petitioner urges that the amendment operates retroactively and governs the ascertainment of gross income for taxable periods prior to the date of its promulgation, * * * We hold that the respondent's tax liability for the year 1929 is to be determined in conformity to the regulation then in force.
>
> Section 605 of the Revenue Act of 1928 provides that "In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect." It is clear from this provision that Congress intended to give to the Treasury power to correct misinterpretations, inaccuracies, or omissions in the regulations and thereby to affect cases in which the taxpayer's liability had not been finally determined, unless, in the judgment of the Treasury, some good reason required that

> such alterations operate only prospectively. The question is whether the granted power may be exercised in an instance where, by repeated reenactment of the statute, Congress has given its sanction to the existing regulation.
>
> Since the legislative approval of existing regulations by reenactment of the statutory provision to which they appertain gives such regulations the force of law, we think that Congress did not intend to authorize the Treasury to repeal the rule of law that existed during the period for which the tax is imposed.

The provisions of Regulations 86 should not be applied to the transactions involved in this case.

RESPONDENT'S ANSWER TO POINTS MADE BY PETITIONER IN BRIEF.

Petitioner's argument is a legislative argument and not a judicial argument, and it should be addressed to the Congress and not to the Court.

Petitioner's main argument, in this as in many other cases, is a legislative argument rather than a legal argument. It is addressed to the desirability of preventing so-called increments from going untaxed, and the desirability of eliminating the complexities of tax administration to the end that the Commissioner's job may be more simple and easy. Since Congress is the branch of government which is supposed to impose taxes, it is obvious that the taxation or non-taxation of so-called increments is a matter of legislative policy. Congress has known of all these matters for many years. So long as our American form of Government is adhered to, it would seem that this Court should not be called upon to apply tax policies and to devise and formulate general statutory schemes for quick and easy collection of taxes.

Petitioner argues that Congress thought, rightly or wrongly, that *Brewster* v. *Gage* defined the date of acquisition to mean the date of decedent's death, regardless of whether it actually passed then or not. His argument is that if Congress had not

so meant, it would have said so. Is it not more reasonable to argue that if Congress had meant what petitioner says he thinks Congress meant, Congress would have simply said, "* * * the basis shall be the fair market value of such property at the date on which decedent died"? Petitioner's argument comes to this: Congress did not say what it meant to say, although it would have been quite easy to say what it meant [1]; therefore, the Court should substitute (in the statute) the words "at decedent's death" for "at the time of such acquisition"—in order to make it easier for the Department to construe the act in the manner in which it desires to construe it.

Petitioner argues that by reason of a "scheme of federal taxation," it must be held that when Congress said that property shall be valued at the date of its acquisition, Congress really meant to say that it should be valued at the date of another's death—regardless of whether under the law of property, the taxpayer actually acquired it then, or not.

Petitioner argues to the effect that the paramount principle, in the scheme of taxation, is that everything must be taxed, regardless of whether the statute specifically lays the tax or not; and that if Congress fails to lay the tax it must be inferred that such failure was inadvertent and the tax must nevertheless be laid, on the general theory applicable to the strict interpretations of statutory exemptions. Respondent challenges that argument.

The paramount principle of taxation is that no one but Congress can lay a tax, and that the subject of the tax is defined by Congress and can not be enlarged by any one. A clear statement of this long established rule is found in *United States* v. *Merriam*, 263 U. S. 179:

> On behalf of the government it is urged that taxation is a practical matter, and concerns itself with the substance of the thing upon which the tax is imposed, rather than with legal forms or expressions. But in statutes levying taxes the literal meaning of the words employed is most

[1] And although an amendment was proposed and passed the House, which said precisely that, such amendment was rejected by Congress.

important, for such statutes are not to be extended by implication beyond the clear import of the language used.

The same case (*U. S.* v. *Merriam*) quotes from the famous rule laid down by the House of Lords in *Partington* v. *Atty. Gen.*, L. R. 4 H. L. 100, 122:

> If the person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, can not bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible in any statute what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute.

The rule is clearly stated in *Gould* v. *Gould,* 245 U. S. 151:

> In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the government, and in favor of the citizen.

This rule has been repeated and invoked by the courts over such a long period of years that it has become axiomatic in the law.[1]

Another paramount canon of construction, with many years of history, is set out in *Old Colony R. Co.* v. *Com'r*, 284 U. S. 552, 560:

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[1] It is impracticable to review all such cases. We call attention to: *United States* v. *Isham*, 17 Wall. 496; *Knowlton* v. *Moore*, 178 U. S. 41; *Eidman* v. *Martinez*, 184 U. S. 578, 583; *Smietanka* v. *First Tr. & Sav. Bk.*, 257 U. S. 602; *Schwab* v. *Doyle*, 258 U. S. 529; *Weiss* v. *Stern*, 265 U. S. 242; *Niagara Falls Brewing Co., Burnet* v., 282 U. S. 648, 654; *Old Colony R. Co.* v. *Com'r*, 284 U. S. 552.

> The rule which should be applied is established by many decisions. "The legislature must be presumed to use words in their known and ordinary signification." * * * "The popular or received import of words furnishes the general rule for the interpretation of public laws." * * * "The plain, obvious and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and ingenuity and study of an acute and powerful intellect would discover."

In *Crooks* v. *Harrelson*, 282 U. S. 55, it is held that the literal meaning of the statute shall not be rejected and a construction adopted in harmony with what is thought to be the spirit and purpose of the law. There must be something to show plainly that the intent of the legislature was that the letter of the statute is not to prevail.

Another paramount rule is that an omission in the statute can not be supplied by a court. Nor can a court supply what is conceived to be an omission, even though it be conceived that, without supplying the omission, the statute would lead to mischievous results. *Crooks* v. *Harrelson, supra; U. S.* v. *Goldenberg*, 168 U. S. 95; *O'Donnell*, 35 B. T. A. 251.

Respondent urges that the *foregoing landmarks of statutory construction* are paramount to the general abstraction that in the general scheme of taxation Congress means to tax all that is comprehended within the statute levying the tax. "Paramount principle" is but the statement of a truism which is to the effect that when Congress says a thing must be taxed, it means what it says. Such a generality, while obvious, can not take precedence over the recognized canons of construction we have noted above.

Petitioner's argument implies that we are here dealing with a statutory exemption. Such is not even remotely the case. There is no question here of statutory exemption and there is no occasion for invoking the doctrine applicable thereto. The matter of capital gains and losses is purely arbitrary and the basis is a purely statutory concept. It is a sword which cuts

both ways. The much labored point about a tax loss on increment in value is entirely illusory. Such a thing may happen in a case where values have increased between a decedent's death and the taxpayer's acquisition. But on the other hand, there are periods of decline in which the trend is down, instead of up, and a *depreciation* instead of an appreciation results—and there is a loss instead of an increment. In such case the rule works the other way and the Government gains by the necessity of the taxpayer taking the lower value as his base. There is no mystery about this. This is not a novel and startling discovery only just now made by the Department, the need for remedying of which is so imperative that it can not wait until the attention of Congress can be brought to it. Congress has always known of it. It's simply a rule which works both ways. The trouble with the present administrative position is that the petitioner wants the rule to work in his favor all the time. He labors the point of "untaxed increment," but he does not mention the other half of the time when the rule works his way.

The Decisions in Maguire, Gambrill, and Campbell cases are not controlling here.

All of those cases arose under a different statute, with a different history, and with a different basic intendment. They arose under the 1928 Act, which prior to its own way through Congress had no legislative history, and of course had no departmental or judicial history. The record of statutory intendment, however, is so plain that its truth can not be missed. Congress had seen the judicial, legislative and departmental history of the term "acquisition" develop and accumulate for about ten years, and through four tax statutes, as bearing upon the construction and meaning of the phrase "time of acquisition." In 1928 Congress decided to be more specific and accordingly provided that in certain circumstances the basic date was that of decedent's death, while in other circumstances it was the date of distribution to the taxpayer. That rule obtained through the 1928 and 1932 Acts.

Congress became dissatisfied with the provisions it had put into the 1928 and 1932 Acts and took counsel as to what to do. The Treasury Department saw no necessity for the change and told Congress so. But Congress had its own legislative purposes and intent. *Congress decided to abandon the rule of thumb and go back to the rule of property.*

At that time it was universally believed (the Department as well as the Courts sharing in the belief) that there was a distinction between vested interests and other interests. Congress undoubtedly believed there was such a distinction, as is shown by the legislative history. The Supreme Court, at that time, thought there was such a distinction since it specified in *Brewster* v. *Gage* that the legatee's right to have his share of the trust estate "vested immediately." A dozen or more Circuit Court decisions show that the Circuit Courts thought that common law property interests were relevant in statutory enactments. The Board's decisions show the same thing.

It was in the light of the common law rules of property, in light of the many Court and Board decisions, and in light of the general and accepted belief that the plain, ordinary, natural and received sense of the word "acquired" was "to obtain as one's own," that Congress decided to abandon the rule of thumb and go back to the defined and decided rule of property. Accordingly it returned to the exact phraseology of the Acts prior to 1928, and again adopted the word "acquisition" because Congress believed the meaning of that word was understood by everybody.

The statute should now be viewed from the point where Congress stood in 1934 and in light of the obvious Congressional understanding and intent at that time.

If property titles and interests, as universally understood in the law, are to cease to have relevancy in tax statutes, that interpretation should only be put upon statutes enacted after Congress had been apprized of that fact.

The recent decisions of this Court in *Maguire, Gambrill*, and *Campbell*, are not controlling here. This is for two reasons: (1) The inherent and basic difference in the statutory concept

between the 1928 Act and the 1934 Act, and (2) the basic predicate upon which those decisions rest is not present in the instant case.

First as to the statutes: The 1928 Act[1] provides by sec. 113 (a) (5) that:

> *If* personal property *was acquired* * * *, or *if* real estate *was acquired* * * *, the basis shall be the * * * value * * * at the time of the death of the decedent.
>
> *If* the property *was acquired* [by the executors from the decedent] * * * the basis * * * shall be the * * * value * * * at the time of the death of the decedent.
>
> In all other cases *if* the property *was acquired* * * * the basis shall be the * * * value * * * at the time of distribution to the taxpayer.

From the foregoing it will be noted that *in every instance* covered by the 1928 Act, the basic value was made to depend upon the condition that the property *was acquired.* The condition is specifically expressed by the conditional word "IF." Thus, no one can validly argue that "if" the "acquisition" of "property" did not take place at date of death, the basic date would nevertheless be the date of death. *Congress was not adopting an arbitrary "value-at-death" rule, and the language of the statute plainly shows it.*

Therefore, unless it can be shown that the taxpayer actually "acquired" the property at decedent's death, then the so-called "value-at-death" rule has no application.

To "acquire the property" one must acquire something of substance.[2] This Court has said over and over again that taxation is a practical matter and that substance must prevail over form. If, therefore, the "acquisition" was nothing of substance, but was only a shadow, a form, a hope, an expectancy, or a possibility, then it can not be said fairly or justly that he "acquired the property."

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[1] And the 1932 Act which is like it.

[2] See the language used in *Maguire's* case, 111 F. (2d) 843, 847, affirmed by this Court that where the taxpayer has a *substantially vested interest at the time of distribution to the trustee,* then distribution to the trustee is distribution to the taxpayer.

Apparently this Court had the foregoing in mind in deciding the *Maguire, Gambrill,* and *Campbell* cases. In the first place, it should be noted that in every one of those cases the taxpayer had acquired a substantial property interest in the trust corpus.[1]

In *Maguire's* case this Court held that where the provisions of the trust were such that the taxpayer was the owner of an interest in the estate, the delivery of the property to a trustee was delivery to the owner because the former received it as the fiduciary or agent of the owner. As noted, the taxpayer in that case had a completely vested remainder interest. According to the opinion, it makes no difference whether such interest or estate is legal or equitable. So long as the will conveyed an ownership in property, the proceeds of that ownership may be delivered or distributed to the owner's representative. The foregoing point is emphasized by the Court in its reference to *Brewster* v. *Gage,* to the effect that there the interest of the residuary legatee was not "absolute." Admittedly, it was not absolute to the extent that the legatee had both title and possession.[2] But it can not be denied that so far as *legal title* went his interest was absolute. The Court in *Brewster* v. *Gage* said: "*Petitioner's right* later to have his share of the residue *vested immediately upon testator's death.*" Now, leaving out for the moment the clause "later to have his share," the language

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[1] In the *Maguire* case, the taxpayer obviously acquired a completely vested interest in the coupons. The only possible question was whether she would get a child's part or whether that part would be increased by her share of her mother's part. No other contingency or condition appears in that case.

In the *Gambrill* case, the taxpayer was (as petitioner admits, Bf. top. p. 20) a remainderman under his grandmother's will. He had a completed vested interest in the corpus after the life income estate of his mother. His was the estate of the usual and typical vested remainderman. As in the case of every living person there was the chance that he might not live to come into possession of the estate, but, if he did not, it went to his issue. Therefore he had the usual common law estate of the ordinary vested remainderman.

In the *Campbell* case, the trust provided that the taxpayer should receive certain specific parts of the trust corpus at certain specific periods with remainder over to her children or her heirs in the event of her not living to receive into possession all the shares of the trust bequeathed and devised to her.

[2] His possession was only delayed to the extent of the time necessary for administration. The beneficiaries, right was subject to no contingency or condition.

of the Court is, "Petitioner's right * * * vested immediately upon testator's death." Therefore his ownership of the remainder was absolute although the possession of it was deferred. To that extent only was it not "absolute."

The Court makes all this clear by saying: "Hence, in case of remainders governed by sec. 113 (a) (5) of the 1928 Act * * * it can not realistically be asserted that the date when the remainderman acquired his interest came later than the time when he obtained an equitable estate *under the testamentary trust,*" and (speaking to *Brewster* v. *Gage*): "That conclusion suggests that the critical date is the time when the legatee acquired some interest in the property * * *."

To that situation the Court applied the value-at-death rule.

The circumstances in the *Maguire* case are analogous to those in *Brewster* v. *Gage*. Maguire had "acquired" a vested and substantial interest and the Court held that the distribution did not have to be into his own hands in order to make it a distribution under the 1928 Act. *It is respectfully submitted that if Maguire had not previously "acquired" a substantial ownership of the property, the decision of this Court would have been otherwise in the Maguire case.*

The *Maguire* decision is grounded upon the fact that the taxpayer had a property interest in the trust res. *In the instant case* the North Carolina Courts have held that respondent did not have any interest or share whatsoever in the trust estate.

Respondent, therefore, respectfully submits that his case is not ruled or controlled by the *Maguire* decision.

In *Gambrill's* case the circumstances were substantially the same. The taxpayer was a vested remainderman. There can be no doubt about that. His interest as vested remainderman was not absolute for the reason that he had not yet secured distribution and possession. But he did have all the interest there was, except that. The Court makes that clear when it says: "* * * We look to the time when the taxpayer first acquired the interest which later ripened into full ownership."

Nothing need be added to the foregoing. The Court saw that taxpayer had owned *vested interests in the estate with a period of postponed possession.* On that basis the Court held that his representative could take distribution in his behalf.

The foregoing case does not rule the instant case because the Courts of North Carolina decided and held: "* * * *the argument was squarely presented to the Court, that the children of R. J. Reynolds owned vested interests in his estate with a period of postponed possession* until they should respectively attain the age of 28 years * * * *which argument was considered by the Court and expressly rejected* * * *."

Campbell's case is substantially similar in its factual aspects to *Maguire* and *Gambrill.* Again, the Court proceeded upon the theory that taxpayer's ownership of the property enabled the executors to make distribution of that ownership interest to taxpayer's agent.

Again the Court discusses the vested interest of a remainderman with possession postponed, and in doing so recognizes the vested nature of that ownership. Said the Court:

> While the property is held in trust, the vested remainderman has no more right of possession and control than the contingent remainderman. Yet *each has acquired* a property interest. The statutory provisions here in question come into play when *that interest* later *ripens into* full ownership * * *.

The point we stress again is that in every one of the above cases the Court first lays down the premise that ownership of the property (i. e., acquisition) occurred at decedent's death. Having established ownership and acquisition, the decision then proceeds to the point in question, viz: "distribution."

In the instant case *the point in issue* is "acquisition." It can not be assumed. It is an issue of fact and law. The law of North Carolina says this, respondent did not acquire any interest in the trust estate. As a matter of fact, aside from the law he never had any part of it.

It would seem to require no argument to establish that the "distribution" of something which already belongs to a person is a vastly different thing than the "acquisition" by that person of something which he did not own, and which did not belong to him, before that acquisition.

In each of the above cases it appears there was a vested interest with a period of postponed possession. We have shown that such was not the circumstance in the instant case.

In *Campbell's* case, it further appeared that taxpayer had an interest subject to defeasance or divestment, and from that he argued that he acquired the securities only from the date when his interest became indefeasible. In the instant case, respondent had no such interest. The Courts of North Carolina decided and held: "* * * *the argument was squarely presented to the Court, that the children of R. J. Reynolds owned vested interests in his estate* * * * *subject only to be divested by death* before arriving at that age (28), *which argument was considered by the Court and expressly rejected.*"

In the *Campbell* decision the Court summarizes by referring to its companion decision in the *Maguire* case, and says:

> As we remarked in *Maguire* v. *Commissioner of Internal Revenue, supra,* the residuary legatee in *Brewster* v. *Gage,* * * * *was held to have acquired his interest at date of death,* though at that time it was not absolute. (Italics supplied.)

It is obvious that a decision holding that a vested remainderman acquired his interest at decedent's death, is not controlling in a case where it appears that the taxpayer acquired no interest at all, or no substantial interest whatever, when the decedent died.

* * * * * *

In all of the above cases the decision is that an owner can receive distribution even though it is made to his agent. Attention is called to the fact that even that rule would seem not to apply in the instant case because of the provision and stipulation contained in "Item Eighth" of the Reynolds will wherein it is provided (R. 20):

> I hereby provide that all payments to be made hereunder to my beneficiaries shall be into their own hands

and not into the hands of others, whether claiming by their authority *or otherwise*.

* * * * * *

It is respectfully submitted that this case is not ruled by the decisions in the *Maguire*, *Gambrill*, and *Campbell* cases

The securities purchased by the Trustee were not acquired by respondent at the time of such purchase.

We have shown heretofore that the decisions of the Courts of North Carolina decided and held that:

1. *No part* of the trust, and *none of the accumulated income* thereof, would have vested in respondent *unless* and *until* he arrived at age 28.
2. The *only interest* which he had in the trust (or any part thereof) was to receive limited payments of income from time to time.

It stands to reason that since respondent had no interest either in the corpus of the trust or in the accumulated income thereof, then he had no interest in securities purchased by the Trustee with such accumulated income or with proceeds from sales of securities constituting the trust corpus. If he did not have an interest in such purchased securities, then patently he did not acquire them when the Trustee purchased them.

The first time he had any interest in those securities was at the time when the will of R. J. Reynolds said that he should have an interest in them, viz, April 4, 1934.

It is admitted that the basic value of these securities in respondent's hands was not their value at date of decedent's death.

Petitioner argues that sec. 113 (a) (5) of the 1934 Act does not provide for such a situation, and that there is no statutory provision specifically covering it, and that, therefore, sec. 113

(a) must be applied in default of anything better to apply. But that argument does not fit this case.

Sec. 113 (a) says that: "The basis of property shall be the cost of such property." *Whose cost?* The statute plainly intended to mean the cost to the person who sold it. That is made plain by the fact that Congress then proceedeu to set forth the exceptions—and in such exceptions are those cases where the seller did not have any cost basis.

It is clear that the instant respondent did not have any *cost* basis, because he did not buy the securities.

In *Maguire*, *Gambrill* and *Campbell* cases, this Court held that the trustee's cost was the taxpayer's basis. But in those cases the Court also held that the taxpayer had a substantial interest[1] in the trust property from the moment of decedent's death. That being so, the rationale of those decisions relative to "distribution" would apply to the purchase of securities by the trustee. This is so because if the taxpayer had an interest in the securities left by the decedent, then he had an interest in the income therefrom, and in the proceeds of any sale thereof. And if he had an interest in such income and proceeds, then he had an interest in the securities which were bought with such income and proceeds. If that be so, then it would follow that if the trustee could take a distribution on behalf of a taxpayer who had a substantial interest, then the trustee could make a purchase on behalf of a taxpayer who had a substantial interest in the purchase money. In such case the purchase price (or cost) to the trustee might be said to be the purchase price (or cost) to the taxpayer.

But no such logic can apply in a case (such as the instant case) where the taxpayer did not have such an interest. The trustee could not receive a distribution as the alter ego of such a person, nor could he make a purchase as the alter ego of such a person.

Therefore, since the trustee's purchase was not (in the instant

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[1] In the decision in *Maguire's* case (111 F. (2d) 843, 847) which was recently affirmed, the Court below stressed the point that the taxpayer had a substantially vested ownership.

case) the purchase of the taxpayer, then the taxpayer's basis can not be said to be "cost" under sec. 113 (a).

It will not be presumed that Congress intended that there should be no basis whatsoever for determining gain or loss; and, per contra, it will be presumed that Congress intended the subject to be covered by the statute. Petitioner argues, in effect, however, that the statute made no provision for such a case, and that he has corrected the Congressional omission by supplying the necessary legislation. He argues that his Regulation 86, Art. 113 (a) (5)–1 (d) rules the case.

In the first place, Regulations 86 were not approved or promulgated until the year after the tax year here in question; and in the second place, Art. 113 (a) (5)–1 (d) shows on its face that it has nothing to do with the instant situation. Let us examine the Regulations.

Under the format of Regulations 86, each section or subsection of the *statute* is set forth in small type, and immediately following such section or subsection, appears the *Article* of the regulations which interpret that section or subsection. The *number* of the "article" corresponds with the number of the "*section*" or "*subsection*" *of the statute* which it interprets.

Thus, on page 177 of Regulations, appears "Sec. 113 (a)" of the statute. Immediately following that section appear the Articles of the Regulation interpreting that section.

Thereafter, on subsequent pages, appear subsections 113 (a) (1), 113 (a) (2), 113 (a) (3), 113 (a) (4) and following each of them appears the Article of the Regulations similarly numbered and identified as interpretative of it.

Thereafter, on page 181 appears *sec.* 113 (a) (5), which is the section here under discussion. Following that section appears *Article* 113 (a) (5) interpreting *section* 113 (a) (5). That *Article* 113 (a) (5) has seven subdivisions—all relating to the section which the article interprets, viz, sec. 113 (a) (5). Among those subdivisions of Article 113 (a) (5) appears Article 113 (a) (5)–1 (d), which reads as follows:

(d) **Property acquired before March 1, 1913; reinvestments by fiduciary.**—If the decedent died before March 1, 1913, the fair market value on that date is taken in lieu of the fair market value on the date of death, but only to the same extent and for the same purposes as the fair market value on March 1, 1913, is taken under section 113 (a) (14).

If the property is an investment by the fiduciary under a will (as, for example, in the case of a sale by a fiduciary under a will of property transmitted from the decedent, and the reinvestment of the proceeds), the cost or other basis to the fiduciary is taken in lieu of the fair market value at the time when the decedent died.

Subdivision (d) by its very terms applies only to property acquired before March 1, 1913, as to which the fiduciary has made a reinvestment. [1]

An article of a regulation interprets the section of the statute to which it relates and it does not construe and interpret some other section. *Walker* v. *United States*, 83 F. (2d) 103, 111.

The *title* of the Article is set out and emphasized by italics. The portion of the title referring to "reinvestments by fiduciary" is set off merely by a semi-colon, showing that it is merely a clause of the main title—"Property acquired before March 1, 1913."

In the *Maguire* case this Court gave significance to the title of sec. 113 (a) (5), "Property transmitted at death," and the language there used is particularly applicable here. The Court said: "It [the title] suggests * * * that the foregoing provision of Art. 113 (a) (5) was confined * * * to the specific property owned by the decedent at his death." In the instant case, the title more than suggests that it is confined to cases where

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[1] If anything more were needed to establish respondent's contention here, it is to be found by referring to Art. 113 (a) (2) (Gifts after December 31, 1920) and Art. 113 (a) (3) (Transfers in Trust after December 31, 1920) in each of which articles appears a subdivision entitled "Reinvestments by fiduciary." This shows that the reference to "Reinvestment by fiduciary" in Art. 113 (a) (5) is *not a general* reference, but is limited to the terms of the Article to which it belongs.

"Property was acquired before March 1, 1913," and "*the property*" is an investment or reinvestment by the fiduciary.

Therefore, we submit that subdivision (d) of Art. 113 (a) (5) is not applicable here because by its position in the Regulations, by its context in relation to the other subdivision of the same article, by its plain terms, and by its title, it is shown to relate to another and different situation than the one here under consideration.

In the instant case, respondent's father did not die before March 1, 1913, and the fiduciary did not receive the property prior to March 1, 1913. In view of the very pointed limitations of the Article itself, it is patent that it does not apply here.

Petitioner argues (Bf. p. 28) that the "value-at-acquisition" should not apply to property purchased by a trustee, because the decedent never owned it.[1] But that argument gets him nowhere, because prior to April 4, 1934, the respondent never owned it either. He "*acquired*" his first interest in the property on that date. The ownership of the trustee was not his ownership, and the cost of the trustee was not his cost. The statute has made provision for the basis, viz, "time of acquisition," and the plain intendment of the statute should be observed.

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[1] Petitioner compares sec. 113 (a) (5) with sec. 113 (a) (3). But that comparison proves nothing because sec. 113 (a) (3) relates only to *inter vivos* transfers in trust after December 31, 1920. The section and the Article of the Regulation interpreting it are as follows:

> (3) **Transfer in trust after December 31, 1920.**—*If the property was acquired after December 31, 1920,* by a transfer in trust (other than by a transfer in trust by a bequest or devise) the basis shall be the same as it would be in the hands of the grantor, increased in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer was made.

Art. 113 (a) (3)-1, construing the above section, says:

> **Art. 113 (a) (3)-1. Transfer in trust after December 31, 1920.**—(*a*) *Property included*—Section 113 (a) (3) applies in general to all property acquired after December 31, 1920, by transfer in trust. It does not apply to property acquired as a *gift* by transfer in trust, or by bequest or devise; or by an instrument which, under section 113 (a) (5), is to be treated as though it were a will. * * *

Respondent acquired all of the securities by bequest, devise or inheritance.

Sec. 113 (a) (5) says the basis shall be the value at "time of acquisition," if it was acquired by bequest, devise or inheritance. Bouvier's Law Dictionary defines "bequest" as "a gift by will of personal property," "devise" as "a gift of real property by last will and testament," and "inheritance" as: "It *includes all the methods* by which a child or relation takes property from another at his death * * *; as applied to personal property it can mean nothing else than to signify succession."

A taxpayer may become entitled to property by bequest, devise or inheritance, even though the decedent did not own it when he died. The point is clearly decided in *Dobbin* v. *Commissioner*, 31 F. (2d) 935, and 72 F. (2d) 984. There taxpayer received, by her husband's will, her husband's interest in a trust established by his brother. As a result of her acquisition of her husband's interest in the trust, taxpayer was to receive certain income later to accrue from the trust corpus. The question was whether the income came within Sec. 213 (b) (3) of the 1918 Act[1] which provided that gross income "does not include * * * (3) The value of property acquired by gift, bequest, devise or descent (but the income from such property shall be included in gross income)."

The Court held that the income to which taxpayer became entitled by reason of the will was a "bequest" within the meaning of Sec. 213 (b) (3). After a rehearing on the subject-matter the Court reaffirmed its decision, 72 F. (2d) 984. From the foregoing it clearly follows that property purchased by a trustee subsequent to decedent's death and acquired by the taxpayer by reason of his heirship, comes within the meaning of "bequest" or "inheritance" whether under the exactly similar provisions of 213 (b) (3) of the 1918 Act, 22 (b) (3) of the 1934 Act, or 113 (a) (5) of the 1934 Act.

The foregoing is supported by *Smith* v. *City of Providence*,

[1] Same as Sec. 22 (b) (3) of the 1934 Act.

9 Atl. (2d) 10, 13, where the Court considered a trust similar to that in *Dobbin's* case, and held that the trust income was part of a bequest.

The word "inheritance" is obviously a general or catch-all term intended to include any method by which property is passed from a decedent to another, which might not be included under "bequest" or "devise." Any provision in a *will* whereby property so passed would undoubtedly be included either in "bequest" or "devise." The word "inheritance" appears generally to apply to cases of intestacy. This is shown by *Commissioner* v. *Fletcher*, 59 F. (2d) 508, 510, where it was held that the word "inheritance" included the means whereby a tenant by the entirety received the property from her co-tenant upon his death.[1]

In *Lyeth* v. *Hoey*, 305 U. S. 188, this Court held that property received by an heir under an agreement compromising a will contest was property acquired by "inheritance" within the meaning of Sec. 22 (b) (3) of the 1932 Act[2] which exempts such property from income tax. This Court said (p. 196):

> Respondent agrees that the word "inheritance" as used in the federal statute is not solely applicable to cases of complete intestacy. The portion of decedent's property which petitioner obtained under the compromise did not come to him through the testator's will. *That portion he obtained because of his heirship* and to that extent he took in spite of the will and as in case of intestacy. (Italics supplied.)

[1] The Court said (p. 510):

> We think the word "inheritance" may be fairly construed to include this transfer, and we are convinced that Congress so intended it. While in legal parlance we generally regard the meaning of the word "inheritance" as the acquisition of property by one person as heir to another, yet it also means the act of possessing, receiving, obtaining, or succeeding to. The right to receive the entire property upon her husband's death came from the deed which created the estate by the entirety. The transfer to her of the interest therein which her husband had at the time of his death, and which transfer was necessary for her to completely hold and enjoy that right which the deed had given her, came from her husband's estate. She succeeded to her husband's right. She received and obtained and came into possession of it, and in that sense we think she must be considered as having inherited it from her husband's estate.

[2] Sec. 22 (b) (3) of the 1932 Act is identical with Sec. 22 (b) (3) of the 1918 Act, and contains the same pertinent provisions as Sec. 113 (a) (5) of the 1934 Act.

Respondent's position is further supported by a consideration of the case of property transferred in contemplation of death. With respect thereto Regulations 62, Art. 1563, provides as follows:

> In computing the gain or loss from the sale or other disposition of property acquired by gift on or before December 31, 1920, or by bequest, devise or inheritance, the basis shall be the fair market price or value of such property at the time of acquisition. The term "property acquired by bequest, devise, or inheritance" as used herein includes (a) such property interests as the taxpayer has received as the result of a transfer, or creation of a trust, in contemplation of or intended to take effect in possession or enjoyment at or after death. * * *.

Since under the Regulations "property interests," which a taxpayer receives as a result of a trust in contemplation of death, were included within the meaning of "bequest, devise, or inheritance," then *a fortiori* property or property interests received as a result of, or flowing from, or arising out of, a will creating a testamentary trust would be so included.

From all of the foregoing the following logical deductions seem inescapable:

Sec. 22 (b) (3) of the 1934 Act excludes from gross income "the value of property acquired by gift, bequest, devise or inheritance * * *." That clause is practically identical with that of Sec. 113 (a) (5) covering "property acquired by bequest, devise or inheritance * * *."

If, following the rationale of the *Maguire* case, the property in question was *not* "acquired by bequest, devise or inheritance" for the purpose of Sec. 113 (a) (5), then it was not "acquired by gift, bequest, devise or inheritance" for the purposes of Sec. 22 (b) (3); and therefore acquisition of such property might be deemed as taxable income.

Quite obviously Congress never meant to bring about any such result. The statute did not intend to treat as taxable income the property which this taxpayer acquired by reason of his heirship or by reason of the provisions of his father's will. It follows that when property is so acquired it must have a

basis, and clearly the only logical basis is its value at the date of acquisition, i. e., when the taxpayer became "entitled" to it.

It appears from the express language of the statute that the words "bequest," "devise" and "inheritance" in the 1934 Act were intended to include any property to which taxpayer became "entitled" as the result of the death of another person or as the result of his heirship. Secs. 113 (a) (5) of the 1928 and 1932 Acts attempted to separate various classes of acquisition arising or growing out of another's death. Sec. 113 (a) (5) of the 1934 Act does not do so. In light of that fact it should be concluded that, under the 1934 Act, the phrase "time of acquisition" means the time when taxpayer became entitled to any and all property which he acquired or "obtained because of his heirship," or acquired by or through or because of his father's will.

PETITIONER'S MOTION TO REVERSE.

Petitioner has heretofore filed a "Motion to Reverse." Thereafter he filed his brief in the cause. The instant brief of respondent is his brief in opposition to petitioner's "Motion to Reverse" and also his brief in the cause.

CONCLUSION.

The decision of the Court below should be affirmed.

Respectfully submitted,

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INDEX TO APPENDIX.

APPENDIX.

Statutes and Regulations.

Sec. 113 (a) (5) of Revenue Act of 1934, c. 277, 48 Stat. 680:

> SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—
>
> (a) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—
>
> *　*　*　*　*　*　*　*　*
>
> (5) *Property Transmitted at Death.*—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition.

Section 202 (a) (3) of the Revenue Act of 1921, c. 136, 42 Stat. 227, provided in part as follows:

> In the case of such property, acquired by bequest, devise, or inheritance, the basis shall be the fair market price or value of such property at the time of such acquisition.

Section 204 (a) (5) of the Revenue Act of 1924, c. 234, 43 Stat. 253, provided in part as follows:

> If the property was acquired by bequest, devise, or inheritance, the basis shall be the fair market value of such property at the time of such acquisition.

Section 204 (a) (5) of the Revenue Act of 1926, c. 27, 44 Stat. 9, was the same as Section 204 (a) (5) of the Revenue Act of 1924.

Section 113 (a) (5) of the Revenue Act of 1928, c. 852, 45 Stat. 791, provided in part as follows:

> *Property Transmitted at Death.*—If personal property was acquired by specific bequest, or if real property was acquired by general or specific devise or by intestacy, the basis shall be the fair market value of the property at the

time of the death of the decedent. If the property was acquired by the decedent's estate from the decedent, the basis in the hands of the estate shall be the fair market value of the property at the time of the death of the decedent. In all other cases if the property was acquired either by will or intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer.

Section 113 (a) (5) of the Revenue Act of 1932, c. 209, 47 Stat. 169, was the same as Section 113 (a) (5) of the Revenue Act of 1928.

Regulations.

Reg. 86 (promulgated in 1935) provides:

Art. 113 (a) (5)-1. Basis of property acquired by bequest, devise, or inheritance.—(*a*) *Property included.*—Section 113 (a) (5) applies—

(1) to all property passing from a decedent by his will or under the law governing the descent and distribution of property of decedents; and

(2) to property passing under an instrument which, under section 113 (a) (5) is treated as though it were a will, but applies to such property only at the times and to the extent prescribed in section 113 (a) (5).

(*b*) *Basis.*—Under the law governing wills and the descent and distribution of the property of decedents, all titles to property acquired by bequest, devise, or inheritance relate back to the death of the decedent, even though the interest of him who takes the title was, at the date of death of the decedent, legal, equitable, vested, contingent, general, specific, residual, conditional, executory, or otherwise. Pursuant to this rule of law, section 113 (a) (5) prescribes a single uniform basis rule applicable to all property passing from a decedent by will or under the law governing the descent and distribution of the property of decedents. Accordingly, the time of acquisition of such property is the death of the decedent, and its basis is the fair market value at the time of the decedent's death, regardless of the time when the taxpayer comes into possession and enjoyment of the property. For example, if distribution of

personal property left by a decedent is not made until one year after his death, the basis of such property in the hands of the legatee is its fair market value at the time when the decedent died, and not when the legatee actually received the property; or, if the bequest is of the residue to trustees in trust, and the executors do not distribute the residue to such trustees until five years after the death of the decedent, the basis of each piece of property left by the decedent and thus received, in the hands of the trustees, is its fair market value at the time when the decedent dies; or, if the bequest is to trustees in trust to pay to A during his lifetime the income of the property bequeathed, and after his death to distribute such property to the survivors of a class, and upon A's death the property is distributed to the taxpayer as the sole survivor, the basis of such property, in the hands of the taxpayer, is its fair market value at the time when the decedent died.

The purpose of the Act, in prescribing a single uniform basis rule for property acquired by bequest, devise, or inheritance, is, on the one hand, to tax the gain, in respect of such property, to him who realizes it (without regard to the circumstances that at the death of the decedent it may have been quite uncertain whether the taxpayer would take or gain anything); and, on the other hand, not to recognize as gain any element of value solely from the circumstance that the possession or enjoyment of the taxpayer was postponed. Such postponement may be, for example, until the administration of the decedent's estate is completed, until the period of the possession of enjoyment of another has terminated, or until an uncertain event has happened. It is the increase or decrease in the value of property reflected in a sale or other disposition which section 113 (a) (5) recognizes as the measure of gain or loss.

Committee Reports.

1928 Act.

The Report of the Joint Committee on Internal Revenue Taxation, dated January 11, 1928, and published as House Document No. 139, 70th Congress, 1st Session, contains the following passage (pp. 17–18):

BASIS FOR GAIN OR LOSS ON SALES BY AN EXECUTOR.

Until recently gain or loss on an executor's sale was measured by the value at the decedent's death of what was sold. As a result of the decision by the Court of Claims in *McKinney* v. *United States*, and the denial of certiorari by the United States Supreme Court, the rule was changed so as to provide that gain or loss on such a sale would be measured as though the decedent had sold the property during his life.

The rule of the *McKinney* case is inconvenient, for it is often impossible to determine the decedent's cost or other basis. Moreover, as a practical matter, it results in taxing the value of bequests, devises, and inheritances as income. The old rule seems preferable, and it is recommended that it be set forth in the statute.

Section 204 (a) (5) prescribes the basis when the beneficiary sells the property as the value at the time of "acquisition." Some doubt has arisen as to what is meant by the date of acquisition. The "date of death" is recommended to make the basis certain and definite.

The applicable portion of the Report of the House Committee on Ways and Means (House Report No. 2, 70th Congress, 1st Session, p. 18) is set out in full at p. 9 of this brief.

The Report of the Senate Committee on Finance (Senate Report No. 960, 70th Congress, 1st Session) contains the following passage (p. 26):

SEC. 113.—BASIS FOR DETERMINING GAIN OR LOSS—EXECUTORS' SALE.

The decision by the Court of Claims in *McKinney* v. *United States* has caused confusion in the existing law as to the basis on which an executor must determine gain or loss on the sale by him of property of the estate. The House bill in Section 113 (a) (5) provides that in such cases the basis shall be the fair market value of the property at the time of the death of the decedent. In the same section the House bill provides the same basis shall be used where the property is sold by the beneficiary.

It appears that the House bill is inadequate to take care

of a number of situations which frequently arise. For example, the executor, pursuant to the terms of the will, may purchase property and distribute it to the beneficiaries, in which case it is impossible to use the value at the decedent's death as the basis for determining subsequent gain or loss, for the decedent never owned the property. Moreover, the fair market value of the property at the decedent's death can not properly be used as the basis, in the case of property transferred in contemplation of death where the donee sells the property while the donor is living.

Accordingly, the committee has revised section 113 (a) (5) and certain related sections, so as to provide that in the case of a specific bequest of personalty or a general or specific devise of realty, or the transmission of realty by intestacy, the basis shall be the fair market value at the time of the death of the decedent. In these cases it may be said, as a matter of substance, that the property for all practical purposes vests in the beneficiary immediately upon the decedent's death, and therefore the value at the date of death is a proper basis for determination of gain or loss to the beneficiary. The same rule is applied to real and personal property transmitted by the decedent, where the sale is made by the executor. In all other cases the basis is the fair market value of the property at the time of the distribution to the taxpayer. The latter rule would obtain, for example, in the case of personal property not transmitted to the beneficiary by specific bequest, but by general bequest or by intestacy. It would also apply in cases where the executor purchases property and distributes it to the beneficiary.

The Conference Report on the Revenue Act of 1928 (House Report No. 1882, 70th Congress, 1st Session) contains the following passage (p. 14):

Section 113 (a) (5) is amended (No. 75) so as to provide that in the case of specific bequest of personalty or a general or specific devise of realty or the transmission of realty by intestacy the basis shall be the fair market value of the property at the time of the death of the decedent. In these cases it may be said, as a matter of substance, that the property for all practical purposes vests in the

beneficiary immediately upon the decedent's death, and therefore the value at the date of death is a proper basis for the determination of gain or loss to the beneficiary. The same rule is applied to real and personal property transmitted by the decedent where the sale is made by the executor. In all other cases the basis is the fair market value of the property at the time of the distribution to the taxpayer. The latter rule would obtain, for example, in the case of personal property not transmitted to the beneficiary by specific bequest, but by general bequest or by intestacy. It would also apply in cases where the executor purchases property and distributes it to the beneficiary; and the House recedes, * * *

1934 Act

The applicable portion of the Report of the Subcommittee of the Committee on Ways and Means, dated December 4, 1933, and entitled "Prevention of Tax Avoidance," is set out at pp. 18, 19 of this brief.

This was followed by a Statement of the Acting Secretary of the Treasury, the relevant paragraph of which is set out at p. 20 in this brief.

The Report of the Ways and Means Committee (House Report No. 704, 73d Cong., etc., pp. 27–28) is substantially the same as the Report of the Subcommittee referred to above. The portion quoted by the Board in the *Augustus* case is as follows:

> Section 113 (a) (5) of the Revenue Act of 1932 is a reenactment of a similar provision contained in the 1928 Act. The change in the 1928 Act was made because there was some doubt as to the meaning of the term "date of acquisition," which was the term used under the Revenue Act of 1926. Since the 1928 Act was passed, the Supreme Court has defined "the date of acquisition" to mean the date of death in the case of all property passing by bequest, devise, and inheritance, whether real or personal. (*Brewster* v. *Gage*, 280 U. S. 327 [2 U.S.T.C. ¶451.]) Section 113 (a) (5) of the bill conforms to the language contained in the Revenue Act of 1926, so that a uniform basis rule may be required in the case of property passing at death, whether

real or personal. The section also includes a provision relating to general powers of appointment exercised by will, which was explained in connection with section 113 (a) (4).

The Report of the Senate Finance Committee (Senate Report No. 558, 73d Cong., etc., pp. 34–35) is simply a transcript of the Report of the Subcommittee, above referred to.

The relevant portions of the Hearings on the 1934 Bill are set forth on pp. 20–21 of this brief.

G. C. M. 10,260, C. B. X–1, 79 (1932).

This ruling, promulgated in 1932, states that it is for the purpose of clarifying the Department's position and stating its reasons for holding that when distribution is made to a trust beneficiary the time of acquisition is the time when substantial ownership is acquired by the beneficiary.

There, B, the testatrix, had in 1880 devised property to D in trust, to pay life income to A, and at A's death to pay income to A's children until the youngest became 21 years of age, at which time the Trustee, D, was to distribute the corpus to such children or their representatives. A died in 1926. All of her children were then 21. Distribution to them was completed in 1927. Sales of the property were made by the recipients in 1928.

The ruling makes an exhaustive analysis of the legislative history, including House and Senate Committee Reports, in order to arrive at the intent of Congress, and, *inter alia*, says as follows:

> The first question is whether the children of A (the grandchildren of the testatrix) "acquired" the property before March 1, 1913. It is concluded that the answer is in the negative, and for two reasons: * * * in the second place, their interests were wholly contingent under the law of Pennsylvania until the death of their mother in 1926; and the position of this office has been that one who has a mere contingent interest does not "acquire" the

property in question until his interest becomes vested. [Citing rulings.] (Mid. p. 80.)

* * * * * * * * *

* * * it will be assumed that the shares of M Company stock were delivered to the beneficiaries in kind on the termination of the trust in 1926. Under this assumption, it would appear at first glance that the basis of such shares, when sold by the beneficiaries in 1928, would be the fair market value of such shares at the time of decedent's death in 1880. * * * Nevertheless, it is entirely clear that Congress can not have intended such cases as the instant case to be governmed by the first sentence of sec. 113 (a) (5), because both the Senate Finance Committee report and the Conference Committee Report specifically state that the first sentence of the subsection was intended to apply to those cases *where the beneficiary secures substantial ownership at the decedent's death* (bot. p. 81). (Italics are those of the Ruling.)

* * * * * * * * *

In the instant case it is evident that the property did not, "as a matter of substance," vest in the grandchildren "immediately upon the decedent's death." * * * even if they were in being at that time, their interests were most unsubstantial because they were entirely contingent upon their continuing to be alive at the death of their mother. * * *

However, it is not necessary to rely solely on the Committee Reports. The very spirit and purpose of sec 113 (a) (5), as revealed not only by the Committee Reports but also by its own language and legislative history, are to fix the basic date at, and not before, the time *substantial ownership is acquired by the particular taxpayer in question* (mid. 82). (Italics supplied.)

After analyzing the decision in *Brewster* v. *Gage* and the *Matthiessen* cases, the Ruling continues:

The third sentence specifically shows that Congress regarded the ownership of an ordinary distributee or general legatee to be *too insubstantial at the decedent's death* to warrant fixing his basic date as of that time. If this is so in the case of an ordinary legatee or distributee where the only contingency involved is the possibility that the

> decedent's estate may be consumed in paying debts, or in satisfying other prior legacies, it is much more true in the case of a taxpayer who is not even in existence at the decedent's death, *or in the case of a taxpayer who*, although then in existence, *has at that time, only a contingent remainder*. The interests of such persons are not only subject to the possibility that the decedent's estate may be consumed by debts, but they are also subject * * * to the contingency that they may never outlive the life tenant. To fix the basic date of the property in the hands of such persons at the time of the decedent's death, while postponing the basic date of the property in the hands of ordinary legatees and distributees until the *date of distribution*, would be inconsistent and unreasonable, and *directly opposed to the spirit and purpose of sec. 113* (*a*) (*5*). *It would achieve the very opposite of what Congress intended* (mid. p. 83). (Italics supplied.)

The ruling then points out that a different interpretation would "cause absurd, illogical, and inconsistent results * * * between contingent remaindermen themselves and * * * contingent remaindermen and ordinary distributees * * * depending on when their remainders vest" and then proceeds, *at mid.* p. 84 *to mid.* p. 85:

> Furthermore, it is well known that the gravest doubt exists as to the constitutionality of *any Federal law* attempting to levy an income tax on sums realized by reason of an increase in value of property occurring before the effective date of the income tax amendment. [*Citing Lucas* v. *Alexander*, 279 U. S. 573.] Yet this would frequently result if the basic date for *contingent remaindermen* of specific bequests or of realty is ascertained under the first sentence of sec. 113 (a) (5).

The situation, then, is this: It is evident on the face of the statute, by comparing the first sentence of section 113 (a) (5) with the third sentence, and by comparing the first sentence with section 113 (b), that Congress could never have intended the first sentence of section 113 (a) (5) to apply to persons *whose interests, at the decedent's death, were not substantial*, and of course not to persons who were not even in existence at that time. An examination of the

committee reports and of the legislative history further establishes this *beyond all shadow of doubt,* and if any reinforcement were necessary it is present in the fact that such an interpretation would raise the *gravest doubts as to the constitutionality of the statute.* This being so, does the mere fact that the literal language of the first sentence applies to all persons acquiring specific bequests and to all those acquiring realty by devise or intestacy, require that such sentence be held applicable to contingent interests in such properties? In the opinion of this office there is no such requirement. It is only necessary to infer four words in two different places in the first sentence of section 113 (a) (5) in order to make the sentence carry out the plain intent of Congress. The sentence would then read:

> If personal property was *substantially* acquired at *decedent's death* by specific bequest, or if real property was *substantially* acquired *at decedent's death* by general or specific devise or by intestacy, the basis shall be the fair market value of the property at the time of the death of the decedent. (Italics are those of the ruling.)

In other words, the phrase, "at decedent's death" and the word "substantially" are inferred in two places in the sentence, and since it is perfectly obvious that this inference corresponds with the intent of Congress, and that any other construction brings about the most illogical, absurd, unjust, and probably unconstitutional results, the insertion of the words is abundantly justified as a matter of statutory construction. [Citing 2 Lewis' Sutherland Statutory Construction, 2d ed., sec. 382.]

* * * * * * * * *

It is of course obvious from the foregoing that the first sentence of section 113 (a) (5) is incongruous and leads to the most absurd results if it includes interests which were not substantially acquired by the taxpayer at the decedent's death. * * *

The Ruling reviews the authorities on statutory construction and says, top. p. 88:

In view of the foregoing, it is the opinion of this office that the first sentence of section 113 (a) (5) is not appli-

cable to personal property acquired by specific bequest, or to real property acquired by general or specific devise, or by intestacy, except in those cases where the taxpayer in question has *acquired substantial ownership of the property at the time of the death of the decedent*, and that, consequently, the basis of the property in the hands of the children of A is not governed by that sentence. (Italics supplied.)

The Ruling then discusses at length the law as to "distribution" and continues, at mid. p. 93:

* * * Obviously, the "time of distribution" that Congress had in mind is the time of distribution of the decedent's *estate* (the "estate" just referred to in the preceding sentence), and not the time of some delivery of corpus attending the distant termination of a trust or legal life estate. It was not the latter question, moreover, which was in issue in the two cases forming the chief legislative background for the third sentence of section 113 (a) (5). The question in issue in those cases (the Matthiessen case, *supra*, and the district court's decision in *Brewster* v. *Gage*, *supra*) was whether a residuary legatee "acquired" any "property" from the decedent prior to the original distribution of the decedent's estate, and Congress enacted the third sentence of section 113 (a) (5) to settle this controversy. There was no controversy over the question of whether the time of a legatee's acquisition of property should be still further deferred until the termination of a testamentary trust or the death of a legatee for life, and Congress must have assumed that distribution to a testamentary trustee or to a tenant for life was distribution to a *vested* beneficiary or *vested* remainderman. (Italics supplied.)

The Ruling then discusses at length the case of *contingent interest* and says, at mid. p. 96:

As already stated the purpose of the foregoing discussion is to present in more complete form the principal reasons underlying the position of the Bureau to the effect that contingent interests in specific bequests and realty are governed by the third sentence of section 113 (a) (5) rather

than by the first sentence, *and to perform a similar task with respect to the position that distribution to a testamentary trustee is distribution to such cestuis que trust as acquire substantial equitable ownership through the distribution to the trustees.* However, under the will of B in the instant case, her grandchildren did not acquire substantial equitable ownership when the property was distributed to the trustees. As stated in the first part of this memorandum, the interests of the grandchildren were contingent until the death of A, the life beneficiary, on June ——, 1926. Contingent beneficiaries or remaindermen are not regarded as having "acquired" property under the Revenue Acts, and, consequently, in such cases "distribution" *as well as acquisition, is necessarily contingent until substantial ownership vests*, at which time distribution to them is automatically concluded. (Italics supplied.)

* * * * * * * * *

In the instant case, since the interests of the grandchildren were contingent until A's death in 1926, and then became substantially vested (all of the grandchildren having then reached the age of 21), it is the opinion of this office that *distribution to the trustee of the testamentary trust did not constitute distribution to the grandchildren but was contingent*, as to them, until their interests substantially vested on A's death in 1926, * * * (mid. p. 97). (Italics supplied.)

At mid. p. 101 the Ruling discusses the matter of the distribution to beneficiaries of securities purchased by the Trustee, and says:

If certificates of stock were delivered to the sons which did not compose part of the original trust corpus but were purchased by the trustee with proceeds of the sale of such corpus, then the basis of such stock in the hands of the sons is the same basis the purchased stock had in the hands of the trustee—which basis, presumably, would be the cost to the trustee. * * * In other words, *with the exception of cestuis que trust whose interests are contingent* * * * the basis * * * is not to be regarded * * * as personal property "acquired by specific bequest" * * *. *On the other hand, where the interest of the cestuis are originally contingent, the property they acquire "by will" is the property as it*

exists when their interests become substantially vested, * * *. (Italics supplied.)

Dissenting Opinion in the Augustus Case, 40 B. T. A.

Black, *dissenting:* It is petitioner's contention in this proceeding that the interest which she received in the property conveyed by her father's will to a testamentary trust was a contingent remainder and that this interest in such property did not become vested until the date of the death of her mother, November 9, 1928.

The law of New York controls the question. *Forbes* v. *Commissioner,* 82 Fed. (2d) 204. Under the laws of the State of New York, I think petitioner had only a contingent remainder under the terms of the testamentary trust. Under the will of petitioner's father, petitioner's mother, the life tenant, had not only the right to the income from the property, but also the right to take for her own use so much of the principal as she might wish or desire, she being the sole judge as to whether she should consume the principal. By the terms of the will it was only the residue of the principal of the fund so remaining in the testamentary trust at her death which was to be disposed of by the trustee to the remaindermen. The remainder thus created was contingent and not vested. See *In matter of Dinkel,* 133 Misc. 868; 234 N. Y. S. 97; *Matter of Nugent,* 142 Misc. 594; 255 N. Y. S. 236; *Matter of Bonner,* 157 Misc. 810; 285 N. Y. S. 283; *Louis Kalb,* 15 B. T. A. 886.

If, under the testamentary trust involved in this proceeding, the remainder interest of petitioner was contingent, petitioner did not "acquire" the property within the meaning of section 113 (a) (5) of the Revenue Acts of 1934 and 1936 until the death of the life tenant. *Lane* v. *Corwin,* 63 Fed. (2d) 767; *Pringle* v. *Commissioner,* 64 Fed. (2d) 863; *Forbes* v. *Commissioner, supra; Louis Kalb, supra.*

The language of 113 (a) (5) of the Revenue Acts of 1934 and 1936 is precisely the same as the language of a similar section in the 1926 Act and prior acts. Although this is true, the

majority opinion construes the language of section 113 (a) (5) of the Revenue Acts of 1934 and 1936 to fix the date of "acquisition" as the same whether the remainder interest is vested or contingent.

This construction given by the majority opinion seems to rest largely upon reports of the House Ways and Means Committee and the Senate Finance Committee, which accompanied the bill which became the Revenue Act of 1934. It seems to me that the reports to which the majority opinion refer went no further than to make plain that the purpose of the language was to adopt the construction which the Supreme Court of the United States had put upon similar language in *Brewster* v. *Gage*. I think that the court in *Pringle* v. *Commissioner, supra*, makes clear that *Brewster* v. *Gage* did not decide the question we have in the instant case. There the court (Ninth Circuit) said, among other things:

> The cases of *Brewster* v. *Gage*, 280 U. S. 321, and *Chandler* v. *Fields*, 63 Fed. (2d) 13, are not controlling here. In each of those cases the interest of the taxpayer became vested immediately upon the death of the testator.

To the same effect, I think, is *Lane* v. *Corwin, supra*, although it involved a different statute.

Under the authorities I have cited, I think the date of petitioner's acquisition of the property in question was the date of the death of her mother, November 9, 1928, which terminated the testamentary trust and vested the property in petitioner, and not the date of the death of her father, July 13, 1922.

For the reasons I have stated, I respectfully dissent from the majority opinion.

Arundell, Van Fossan, Murdock, and Disney agree with this dissent.

Dissenting Opinion in the Archbold Case, 40 B. T. A.

KERN *dissents.*

BLACK, *dissenting:* It is the contention of petitioners in these proceedings that in the deeds of trust involved there were no words making a present gift of the remainders to the petitioners. That the only so-called "words of gift" are found in the direction to transfer the *corpora* of the trusts to the respective petitioners upon the happening of a future contingency, viz., their reaching the age of twenty-one years; that in view of this, it follows that futurity was annexed to the substance of the gifts and, therefore, the time of vesting of the remainders was suspended until the happening of the contingency upon which the gift was limited.

The law of New York controls the question whether the remainders were vested or contingent. *Forbes* v. *Commissioner,* 82 Fed. (2d) 204. Under the laws of New York, I think they were contingent. *Lewisholm* v. *Henry,* 179 N. Y. 352; *Dickerson* v. *Sheehy,* 156 App. Div. 101; affirmed without opinion, 209 N. Y. 592. If, under the deeds of trust involved in these proceedings, the remainder interests of petitioners were contingent, then they did not "acquire" the property within the meaning of section 113 (a) (4) of the Revenue Act of 1932 until the happening of the contingency upon which the remainders were limited. Then it was that their interest in the property became vested. *Lane* v. *Corwin,* 63 Fed. (2d) 767; *Pringle* v. *Commissioner,* 64 Fed. (2d) 863; *Forbes* v. *Commissioner, supra.* The vesting of the interest of the petitioners in the properties here involved occurred at the time each of them reached the age of twenty-one years and the securities were distributed to them. The fair market value on that date, I think, is the basis which should be used for determining gain or loss, rather than the basis determined in the majority opinion.

For the reasons I have stated, I respectfully dissent from the views of the majority.

ARUNDELL, VAN FOSSAN, MURDOCK, and DISNEY agree with this dissent.